

INTERNAL REVENUE BULLETIN



HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

EXCISE TAX, EXEMPT ORGANIZATIONS

T.D. 9938, page 838.

Section 4960 imposes an excise tax on remuneration in excess of \$1 million and excess parachute payments paid by an applicable tax-exempt organization (and its related organization(s)) to a covered employee. These regulations explain how to determine the amount of remuneration paid, whether there is an excess parachute payment, what is an excess parachute payment, what is an applicable tax-exempt organization, what is a related organization, and how to determine an organization's covered employees, and how to report and pay the tax. REG-122345-18. Published January 19, 2021.

Bulletin No. 2021-7
February 16, 2021

INCOME TAX

Notice 2021-10, page 888.

This notice provides additional relief under section 7508A of the Internal Revenue Code (Code) for qualified opportunity funds (QOFs) and their investors in response to the ongoing Coronavirus Disease 2019 (COVID-19) pandemic. This notice also provides additional relief pursuant to section 1400Z-2(f)(3) and Income Tax Regulations under section 1400Z-2 of the Code (section 1400Z-2 regulations). Specifically, this notice extends the relief for QOFs and their investors provided by Notice 2020-39, 2020-26 I.R.B. 984.

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned

against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

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Part I

26 CFR 53.4960-0 through 53.4960-6

T.D. 9938

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 53

Tax on Excess Tax-Exempt Organization Executive Compensation

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document sets forth final regulations under section 4960 of the Internal Revenue Code (Code), which imposes an excise tax on remuneration in excess of \$1,000,000 and any excess parachute payment paid by an applicable tax-exempt organization to any covered employee. The regulations affect certain tax-exempt organizations and certain entities that are treated as related to those organizations. **DATES:** *Effective Date:* These final regulations are effective on January 15, 2021.

Applicability Dates: For dates of applicability, see §53.4960-6.

FOR FURTHER INFORMATION CONTACT: William McNally at (202) 317-5600 or Patrick Sternal at (202) 317-5800 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document amends the Foundation and Similar Excise Tax Regulations (26 CFR part 53) by adding final regulations under section 4960. Section 4960 was added to the Code by section 13602 of the Tax Cuts and Jobs Act, Pub. L. 115-97, 131 Stat. 2054, 2157 (TCJA). Section 4960(a) generally provides that

an applicable tax-exempt organization (ATEO) that pays to a covered employee remuneration in excess of \$1 million for a taxable year or any excess parachute payment is subject to an excise tax on the amount of the excess remuneration (as described in section IV of the Summary of Comments and Explanation of Revisions, titled “Excess Remuneration”) plus excess parachute payments paid during that taxable year at a rate equal to the rate of tax imposed on corporations under section 11 (currently 21 percent). Section 4960 is effective for taxable years beginning after December 31, 2017.

An ATEO is defined in section 4960(c) (1) as any organization that for the taxable year is exempt from taxation under section 501(a) as well as certain other tax-exempt organizations. A covered employee is defined in section 4960(c)(2) as any employee (including any former employee) of an ATEO if the employee is one of the five highest-compensated employees of the organization for the taxable year or any preceding taxable year beginning after December 31, 2016. Section 4960(c)(4)(A) provides that remuneration paid to a covered employee by an ATEO includes any remuneration paid with respect to employment of such employee by any related person or governmental entity. Section 4960(c)(4)(B) defines a related person or governmental entity as an entity that controls, or is controlled by, the ATEO; is controlled by one or more persons that control the ATEO; or is a supported or supporting organization as described in sections 509(f)(3) and 509(a) (3), respectively. An excess parachute payment is defined in section 4960(c)(5) (A) as an amount equal to the excess of any parachute payment over the portion of the base amount (as described in section V.D. of the Summary of Comments and Explanation of Revisions, titled “Three-Times-Base-Amount Test”) allocated to such payment; section 4960(c)(5) (B) defines a parachute payment as any payment in the nature of compensation to a covered employee if the payment is contingent on the employee’s separation from employment with the employer and the aggregate present value of such payments exceeds 3-times the base amount.

On December 31, 2018, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) issued Notice 2019-09 (2019-04 I.R.B. 403), setting forth initial guidance on the application of section 4960. On June 11, 2020, the Treasury Department and the IRS published proposed regulations on section 4960 in the **Federal Register** (REG-122345-18, 85 FR 35746) (the proposed regulations). The statutory provisions and the initial guidance provided by Notice 2019-09 are described in detail in the proposed regulations.

The Treasury Department and the IRS received written comments on the proposed regulations. No public hearing was requested or held. All written comments received in response to the proposed regulations are available at www.regulations.gov or upon request. Comments received that are outside of the scope of the proposed regulations generally are not addressed in this preamble but may be considered in connection with future guidance projects. After consideration of the relevant comments received, the proposed regulations under section 4960 are adopted as final regulations as modified by this Treasury Decision. The major areas of comment and the revisions to the proposed regulations are discussed in the Summary of Comments and Explanation of Revisions. With respect to provisions in the proposed regulations on which no comments were received or for which comments were received prior to the issuance of the proposed regulations, the preamble to the proposed regulations may provide additional information.

Summary of Comments and Explanation of Revisions

These final regulations provide guidance on the excise tax imposed by section 4960 and the entities that are subject to the tax.

I. Scope of Final Regulations

These final regulations retain the basic approach and structure of the proposed regulations, with certain revisions. These final regulations restate certain statutory

definitions and define various terms set forth in section 4960. These final regulations also provide rules for determining: the amount of remuneration paid for a taxable year for purposes of identifying covered employees and calculating the excise tax; whether excess remuneration has been paid and in what amount; whether a parachute payment has been paid and in what amount; the allocation of liability for the excise tax among related organizations; and the date of applicability of these final regulations. These definitions and rules apply solely for purposes of section 4960.

II. Definitions

A. Applicable Tax-Exempt Organization

These final regulations adopt the definition of “applicable tax-exempt organization” or “ATEO” as set forth in the proposed regulations. Consistent with section 4960(c)(1), the proposed regulations provided that an “applicable tax-exempt organization” or “ATEO” includes an organization that is exempt from tax under section 501(a); is a farmers’ cooperative organization described in section 521(b)(1); has income excluded from taxation under section 115(1); or is a political organization described in section 527(e)(1).

In response to comments on Notice 2019-09 regarding the applicability of the excise tax imposed by section 4960 to certain Federal instrumentalities, section II.A. of the Explanation of Provisions of the proposed regulations, titled “Applicable Tax-Exempt Organization,” stated that the Treasury Department and the IRS consider all Federal instrumentalities described in section 501(c)(1) to be included in the statutory ATEO definition as an organization exempt from tax under section 501(a) and thus subject to section 4960. However, the Treasury Department and the IRS requested comments regarding the application of section 4960 to Federal instrumentalities. One commenter requested that these final regulations confirm that Federal instrumentalities described under section 501(c)(1)(A)(i), for which the enabling acts provide for exemption from all current and future Federal taxes are not subject to tax under section 4960. These final regulations do not address this

issue but reserve §53.4960-1(b)(3) and §53.4960-4(a)(5) for future rules to address these Federal instrumentalities. The Treasury Department and the IRS will continue to consider whether section 4960 should apply to Federal instrumentalities for which the enabling acts provide for exemption from all current and future Federal taxes. Until further guidance is issued, a Federal instrumentality for which an enabling act provides for exemption from all current and future Federal taxes may treat itself as not subject to tax under section 4960 as an ATEO or related organization. However, if that Federal instrumentality is a related organization of an ATEO, remuneration it pays must be taken into account by that ATEO.

B. Applicable Year

Section 4960(a)(1) refers to remuneration paid “for the taxable year,” but does not specify which taxpayer’s taxable year is referenced, what it means for remuneration to be paid “for” a taxable year, or how to measure remuneration if an ATEO and a related organization have different taxable years. The proposed regulations provided that remuneration is treated as paid for a taxable year if it is paid during the applicable year, and that the applicable year is defined as the calendar year ending with or within an ATEO’s taxable year. The proposed regulations provided rules for determining the applicable year of an organization with respect to the taxable year in which the organization becomes an ATEO or ceases to be an ATEO, including rules addressing short applicable years that may arise in these situations and rules addressing related organizations with different taxable years. No comments were received on those proposed rules, and these final regulations adopt those rules without change.

C. Employee

Section 4960(a) imposes a tax on excess remuneration and any excess parachute payment paid by an ATEO for the taxable year with respect to employment of a covered employee. Section 4960(c)(2) defines a “covered employee” as an employee (including any former employee) of the ATEO who meets certain other

conditions. Accordingly, the excise tax imposed by section 4960(a) applies only with respect to a current or former employee of the ATEO.

The proposed regulations defined “employee” by reference to the definition of “employee” for purposes of Federal income tax withholding in section 3401(c) and the regulations thereunder. Specifically, the proposed regulations cross-referenced the definition of “employee” in §31.3401(c)-1, which includes common-law employees, officers or elected or appointed officials of governments, or agencies or instrumentalities thereof, and certain officers of corporations. The proposed regulations restated certain rules from §31.3401(c)-1 that are particularly relevant to section 4960, including the rules that a member of a board of directors of a corporation is not an employee of the corporation (in the member’s capacity as a director), and that an officer is an employee of the entity for which the officer serves as an officer (unless the officer performs no services or only minor services and neither receives, nor is entitled to receive, any remuneration for such services). For further discussion, see section II.E. of this Summary of Comments and Explanation of Revisions, titled “Covered Employee.” No comments were received on those proposed rules, and these final regulations adopt those provisions of the proposed regulations without change.

One commenter requested clarification regarding the source of the remuneration that is considered for purposes of applying the minor services exception to the rule that treats a corporation’s officer as an employee. The minor services exception in Prop. §53.4960-1(e)(1) incorporated the standard in §31.3401(c)-1 and provided that “an officer of a corporation who as such does not perform any services or performs only minor services and who neither receives, nor is entitled to receive, any remuneration is not considered to be an employee of the corporation solely due to the individual’s status as an officer of the corporation.” The commenter stated that it is unclear whether an individual qualifies for the exception if he or she receives remuneration from a related person or governmental entity for services performed for an organization other than the ATEO and also volunteers his or her time

as an officer of the ATEO (and performs no services or only minor services for the ATEO). The commenter recommended that these final regulations clarify that the relevant remuneration for purposes of meeting the minor services exception is only remuneration paid by the ATEO. The minor services exception applies if an individual is not paid (nor is entitled to be paid) remuneration based “solely” on the individual’s status as an officer. Thus, the source of the remuneration is not relevant, but rather the standard is whether the individual received any remuneration for the minor services as an officer regardless of the source of the remuneration. Therefore, the Treasury Department and the IRS have concluded that this clarification of the minor services exception in these final regulations is unnecessary.

For a discussion of how this definition of “employee” and other rules address employees of non-ATEO related organizations performing limited or temporary services for the related ATEO (in particular, while also receiving compensation from the non-ATEO related organization), see section II.E.5. of this Summary of Comments and Explanation of Revisions, titled “Volunteer Services and Other Exceptions.”

D. Employer

Section 4960(b) provides that the employer is liable for the tax imposed under section 4960(a). Similar to the definition of “employee,” the proposed regulations defined “employer” by reference to the definition of “employer” for purposes of Federal income tax withholding in section 3401(d) and the regulations thereunder, without regard to the special rules in section 3401(d)(1) and (2). Accordingly, control of the payment of wages would not be relevant for determining whether an entity is the employer for section 4960 purposes. Further, the proposed regulations provided that a person or governmental entity does not avoid status as an employer of an employee by using a third-party payor to pay remuneration to that employee. Third-party payors include a payroll agent, an agent under section 3504, a common paymaster, a statutory employer under section 3401(d)(1), or a certified professional employer organization under section 7705 (which is

an “employer” only for purposes of subtitle C of the Code). Similarly, consistent with existing principles for determining the employer, under certain facts and circumstances, a management company may also be acting as a third-party payor for the employees of its ATEO client, rather than as the common law employer of the employees. Thus, the proposed regulations provided that remuneration that is paid to an individual by a separate organization for services the individual performed as an employee of the ATEO would be remuneration paid by the ATEO to its employee for purposes of section 4960, whether or not the separate organization is related to the ATEO. In addition, the proposed regulations provided that the sole owner of an entity that is disregarded as separate from its owner under §301.7701-2(c)(2)(i) would be treated as the employer of any employee of the disregarded entity, notwithstanding that the entity is regarded for subtitle C purposes under §301.7701-2(c)(2)(iv). No comments were received on these provisions of the proposed regulations, and these final regulations adopt them without change.

E. Covered Employee

1. In General

Section 4960(c)(2) defines “covered employee” as any individual who is one of the five highest-compensated employees of the ATEO for a taxable year or was a covered employee of the ATEO (or any predecessor) for any preceding taxable year beginning after December 31, 2016. Thus, once an employee is a covered employee of an ATEO, the employee continues to be a covered employee for all subsequent taxable years of that ATEO. The proposed regulations provided that whether an employee is one of the five highest-compensated employees of an ATEO is determined separately for each ATEO and not for an entire group of related organizations. As a result, a group of related ATEOs could have more than five “five highest-compensated employees” for a taxable year. Similarly, an employee could be a covered employee of more than one ATEO in a related group of organizations for a taxable year. No comments were received on these provisions of the

proposed regulations, and these final regulations adopt them without change.

2. Aggregation of Remuneration Paid By the ATEO and Its Related Organizations For Purposes of Determining the Five Highest-Compensated Employees

For purposes of determining whether an employee is one of an ATEO’s five highest-compensated employees for a taxable year, the proposed regulations provided that remuneration paid by the ATEO during the ATEO’s applicable year is aggregated with remuneration paid by any related organization during the ATEO’s applicable year, including remuneration paid by a related taxable organization or governmental entity, for services performed as an employee of that related organization. Remuneration for which a deduction is disallowed under section 162(m) generally is not considered for purposes of determining whether excess remuneration is paid for a taxable year, but that remuneration is considered for purposes of determining an ATEO’s five highest-compensated employees.

One commenter suggested that, for purposes of determining an ATEO’s five highest-compensated employees, these final regulations should consider only remuneration paid (directly or indirectly) by an ATEO for services provided by an employee to the ATEO, rather than aggregating all remuneration paid to the individual for services the individual provides as an employee of the ATEO and as an employee of any related organization, including a related non-ATEO (for example, a taxable organization). The commenter reasoned that aggregating remuneration for purposes of determining covered employee status is not required by the statutory text and is unnecessary to comply with Congressional intent to achieve parity between ATEOs and publicly held corporations that are subject to the section 162(m) deduction disallowance for compensation paid to a covered employee in excess of \$1 million. The commenter also reasoned that because only an ATEO can have a “covered employee” under section 4960(c)(2), the reference to the “five highest-compensated employees of the organization” (emphasis in comment) in section 4960(c)(2)(A) should be read to include only com-

pensation paid by the ATEO, directly or indirectly (for example, by reimbursing another entity), for services provided by the employee to the ATEO, regardless of the payor. The commenter asserted that the language in section 4960(c)(4)(A), which provides that “remuneration of a covered employee by an [ATEO] shall include any remuneration paid with respect to employment of such employee by any related person or governmental entity” (emphasis in comment) should not override a plain reading of section 4960(c)(2), which refers only to employment with the ATEO. The commenter further reasoned that section 4960(c)(4)(A) applies after a determination of the ATEO’s covered employees has already been made, and thus it is circular to read section 4960(c)(4)(A) as requiring inclusion of remuneration paid to a covered employee of an ATEO by a related person or governmental entity for purposes of determining an ATEO’s highest-compensated employees (and, thus, its covered employees).

While the Treasury Department and the IRS acknowledge that alternative interpretations as to whether sections 4960(c)(2) and (c)(4)(A) take into account remuneration paid by a related organization for purposes of determining an ATEO’s covered employees may be reasonable, for the reasons set forth below, these final regulations adopt the relevant provisions of the proposed regulations without change and do not adopt the commenter’s recommendation. Section 4960 does not define the “five highest-compensated employees” of an ATEO. The ambiguity in this term is highlighted by the fact that the only provision in the statute that references “compensation” is section 4960(c)(2), which defines “covered employee” as one of the “5 highest compensated employees”; the statute otherwise uses the defined terms “remuneration” and “parachute payment” for purposes of determining the excise tax imposed by section 4960. In addition, there is no discussion in the legislative history describing how Congress intended an ATEO to determine its five highest-compensated employees. The Treasury Department and the IRS have concluded that the commenter’s suggested interpretation—that only remuneration paid by the ATEO for services performed for the ATEO should be considered for

purposes of determining who is a covered employee—would raise significant tax administration issues and the potential for abuse in circumstances in which an individual provides services to, and receives compensation from, the ATEO and one or more related organizations during the applicable year. In these cases, it may be difficult to determine the proper allocation of the compensation among the organizations to which the individual provides the services and whether the allocation was properly based on the value of the services provided. Due to the highly factual nature of this analysis and the potential for differing conclusions on one or more of these issues, the commenter’s suggested rule would result in an unpredictable standard to be applied by taxpayers and the IRS and would raise the potential for abusive mischaracterizations of the nature of the services and compensation provided.

The commenter further asserted that the requirement to aggregate compensation paid by the ATEO and all related organizations is not required to ensure parity with the rules for identifying covered employees under section 162(m). Under §§1.162-27(c)(2)(ii) and 1.162-33(c)(1)(ii)(B), the amount of compensation used to identify the covered employees who are the three most highly compensated executive officers (other than the principal executive officer and the principal financial officer) for the taxable year is determined pursuant to the executive compensation disclosure rules under the Securities Exchange Act of 1934. Under 17 CFR §229.402(a)(2), the amount of compensation paid to an employee by a publicly held corporation is measured by reference to remuneration paid by the registrant and remuneration paid by the registrant’s subsidiaries, and is not limited to remuneration for services provided to the registrant. Although the provisions of sections 4960 and 162(m) are similar in many respects, there is no indication in the legislative history that sections 162(m) and 4960 are intended to apply in the same manner in all situations. Further, the section 162(m) and section 4960 statutory language and the application of the rules differ significantly in many respects that would not allow that strict parity. Regardless of the conclusion that the sections 162(m) and 4960 rules do not allow for strict parity, the Treasury

Department and the IRS have concluded that the aggregation of compensation paid by all related entities in identifying covered employees is more analogous to the rules under section 162(m) than considering only remuneration for services provided to the ATEO.

Thus, while the Treasury Department and the IRS considered several alternatives for determining the ATEO’s five highest-compensated employees, including the alternative proposed by the commenter, the Treasury Department and the IRS ultimately concluded that including remuneration paid by all related organizations is appropriate and that it is more administrable to use a single standard for identifying covered employees and computing the excise tax, if any, imposed by section 4960(a)(1). However, to mitigate the effect of requiring the aggregation of remuneration paid by an ATEO and all related organizations for purposes of determining the ATEO’s covered employees, these final regulations retain the limited hours, nonexempt funds, and limited services exceptions (discussed in section II.E.5. of this Summary of Comments and Explanation of Revisions, titled “Volunteer Services and Other Exceptions”).

3. Remuneration for Medical Services

Consistent with section 4960(c)(3)(B) and the proposed regulations, these final regulations provide that for purposes of identifying an ATEO’s five highest-compensated employees for a taxable year, remuneration paid during the applicable year for medical services is not taken into account. For a discussion of the rules for determining the remuneration paid for medical or veterinary services and for allocating remuneration to medical and non-medical services, see section II.F. of this Summary of Comments and Explanation of Revisions, titled “Medical Services.”

4. Covered Employee Status Continues for all Subsequent Taxable Years

In accordance with section 4960(c)(2), the proposed regulations provided that a covered employee includes any employee (including any former employee) of an ATEO who was a covered employ-

ee of the organization (or a predecessor) for any preceding taxable year beginning after December 31, 2016. In response to the proposed regulations, one commenter suggested that the Treasury Department and the IRS reconsider the rule that an individual who is a covered employee of an ATEO (or of a predecessor ATEO) for one taxable year remains a covered employee of that ATEO (and any successor ATEOs) for all subsequent taxable years. The commenter suggested that an ATEO should be relieved of the burden of continuing to include an employee among its covered employees when a consolidation or restructuring of a tax-exempt organization results in changes to the employee's job responsibilities and compensation, if it no longer furthers the purpose of the statute to include the employee among its covered employees. The commenter asserted that the requirement that an individual remain a covered employee for all subsequent years, even after the employment relationship has ended, creates a potentially excessive administrative burden for the ATEO. These final regulations do not adopt this suggestion because that rule would be inconsistent with the statutory language.

5. Volunteer Services and Other Exceptions

The proposed regulations provided certain exceptions to the definition of "covered employee" and the rules for identifying the five highest-compensated employees of an ATEO. Several commenters supported the inclusion of the exceptions provided in Prop. §53.4960-1(d) (2)(ii), (iii), and (iv). These final regulations adopt these exceptions with certain modifications in response to comments as discussed later in this section.

The exceptions to the definition of "covered employee" in the proposed regulations were provided in response to comments on Notice 2019-09 expressing concern that the rules for identifying an ATEO's five highest-compensated employees in the notice would subject a non-ATEO to the excise tax on remuneration it pays to an employee who performs limited or temporary services for a related ATEO and who typically receives remuneration only from the non-ATEO. The

exceptions were intended to ensure that certain employees of a related non-ATEO providing services as an employee of an ATEO are not treated as one of the five highest-compensated employees of the ATEO, and thus considered a covered employee, if certain conditions related to the individuals' remuneration or hours of service are met. To avoid manipulation of the rules through the deferral of compensation, in determining whether an employee is one of the five highest-compensated employees, the proposed regulations provided that a grant of a legally binding right to vested remuneration is considered to be remuneration paid, and any grant of a legally binding right to nonvested remuneration by the ATEO (or a related ATEO), for example under a deferred compensation plan or arrangement, disqualifies the ATEO from claiming a relevant exception. No comments were received on those proposed rules, and these final regulations adopt those rules without change.

a. No Remuneration and Non-Employment Exceptions

The proposed regulations provided that the remuneration paid to an individual who is never an employee of an ATEO is not considered for purposes of section 4960. For example, an individual who, under all the facts and circumstances, performs services for an ATEO solely as a bona fide independent contractor is not an employee of the ATEO, and thus is not considered for purposes of determining the ATEO's five highest-compensated employees. Similarly, an individual who, under all the facts and circumstances, performs services solely as a bona fide employee of a related organization, including a related organization that provides services to the ATEO, is not an employee of the ATEO, and thus is not considered for purposes of determining the ATEO's five highest-compensated employees. No comments were received on those provisions of the proposed regulations, and these final regulations adopt them without change.

The proposed regulations further provided that, for purposes of determining an ATEO's five highest-compensated employees for a taxable year, an employee is disregarded if neither the ATEO nor any related organization pays remuneration or

grants a legally binding right to nonvested remuneration for services the individual performed as an employee of the ATEO or any related organization. Thus, if none of an ATEO's employees received remuneration from the ATEO or from a related organization, then the ATEO has no covered employees. Benefits excluded from gross income are not considered remuneration, including expense allowances and reimbursements under an accountable plan (see §1.62-2) and most insurance for liability arising from service with an ATEO, such as directors and officers liability insurance (see §1.132-5(r)(3)). These final regulations adopt these provisions of the proposed regulations without change.

In section II.E.2. of the Explanation of Provisions of the proposed regulations, titled "Volunteer Services and Similar Exceptions," the Treasury Department and the IRS requested comments on whether certain taxable benefits, such as employer-provided parking in excess of the value excluded under section 132, should be disregarded for purposes of determining whether an individual receives remuneration for services and what standards should apply to identify those benefits. No comments were received on this issue. Because taxable fringe benefits that are wages within the meaning of section 3401(a) are included in the statutory definition of remuneration, these final regulations adopt the provisions of the proposed regulations providing that these amounts are considered for purposes of determining an ATEO's five highest-compensated employees and for purposes of applying the exceptions from covered employee status. For a discussion of comments received on the exclusion of taxable fringe benefits from the definition of remuneration for purposes other than the determination of the five highest-compensated employees, see section III.A. of this Summary of Comments and Explanation of Revisions, titled "In General" under "Remuneration."

b. Limited Hours Exception

These final regulations adopt the "limited hours" exception as provided in the proposed regulations for purposes of determining an ATEO's five highest-compensated employees. Under this exception, an employee of an ATEO is disregarded

for purposes of determining the ATEO's five highest-compensated employees for a taxable year if neither the ATEO nor any related ATEO pays remuneration or grants a legally binding right to nonvested remuneration to the employee for services performed for the ATEO and the employee performs only limited hours of service for the ATEO. For purposes of this exception, an ATEO is not treated as paying an amount paid to an individual by a related organization that employs the individual, so long as the ATEO does not reimburse the payor. An employee qualifies for this exception only if the hours of service the employee performs as an employee of the ATEO and all related ATEOs comprise 10 percent or less of the employee's total hours of service for the ATEO and all related organizations during the applicable year. For purposes of this rule, an employee who performs fewer than 100 hours of service as an employee of an ATEO (and all related ATEOs) during an applicable year is treated as having worked no more than 10 percent of the employee's total hours for the ATEO (and all related ATEOs).

One commenter recommended that these final regulations replace the 10 percent hours of service threshold in the limited hours exception with the 50 percent hours of service threshold that is used for the nonexempt funds exception (discussed later in this section) because the 10 percent threshold fails to capture many common arrangements between ATEOs and taxable related organizations controlled by the ATEO ("controlled taxable related organizations") that are not structured to avoid the excise tax imposed by section 4960. These final regulations do not adopt this suggestion because the limited hours exception was intended to address arrangements in which services are sufficiently limited so that the arrangements resemble volunteer arrangements. This exception therefore has a much lower hours of service threshold than the nonexempt funds exception but may be used by a broader group of ATEOs. Further, the Treasury Department and the IRS have concluded that adopting the commenter's suggestion

would be inconsistent with the legislative intent of section 4960. As explained in section II.E.2 of the Explanation of Provisions of the proposed regulations, titled "Volunteer Services and Similar Exceptions," the legislative history indicates that Congress intended to tax excessive compensation paid to covered employees from tax-exempt funds.¹ Consistent with this intent, the proposed regulations provided a nonexempt funds exception, which applies if certain criteria are satisfied, but does not apply if an ATEO's controlled taxable related organization pays remuneration to an employee of the ATEO. The Treasury Department and the IRS reasoned that a controlled taxable related organization that pays remuneration to an employee for services provided to an ATEO uses the ATEO's funds to do so, either because the controlled taxable related organization's assets are, effectively, the ATEO's assets, or because the payment reduces the related organization's assets, which in turn reduces the value of the ATEO's interest in the related organization. The Treasury Department and the IRS consider the funds of an ATEO's controlled taxable related organization as, in substance, equivalent to tax-exempt funds, and thus the use of such funds to compensate an individual for services provided to an ATEO is in substance the use of tax-exempt funds.²

One commenter expressed concern about the "cliff" nature of the proposed limited hours exception (as well as the nonexempt funds and limited services exceptions), noting that exceeding the thresholds even slightly may result in the employee being a covered employee for the applicable year and all subsequent applicable years. The commenter recommended that these final regulations allow a 3-year (or longer) measurement period to qualify for the limited hours exception or the other exceptions, primarily to prevent the ATEO from inadvertently failing to satisfy the exception.

A 3-year measurement period would reduce the potential for inadvertent failures for an employer intending to be at or below the threshold for every applicable

year. However, for an employer that intends to meet the limited hours exception during only one applicable year, the suggested 3-year standard would effectively raise the 10 percent hours of service limit to 30 percent and create a new "cliff" at that 30 percent threshold. In addition, permitting a 3-year measurement period would create additional complexity and burdens for taxpayer compliance and tax administration. For these reasons, the Treasury Department and the IRS do not adopt this suggestion. However, the modification to the nonexempt funds exception described later in this section, expanding the measurement period to two applicable years, is intended to address some of the commenter's concerns with respect to inadvertent failures to meet the requirements of the nonexempt funds exception.

Another commenter recommended that Example 5 in the provisions of the proposed regulations, which illustrated the application of the limited hours exception (Prop. §53.4960-1(d)(3)(v)), be modified to eliminate from the facts that ATEO 5 does not control CORP 3, as control of another corporation by an ATEO is irrelevant for purposes determining whether the requirements of this exception are met, and thus irrelevant to the conclusion in that example. The commenter further suggested that this fact be moved to Example 8 in the proposed regulations, which illustrated the application of the separate nonexempt funds exception (Prop. §53.4960-1(d)(3)(viii)), since control of another corporation by an ATEO is relevant for determining whether the requirements of that exception are met, and thus relevant to the conclusion in that example. The Treasury Department and the IRS agree with the commenter's suggestion, and modified Example 5 in these final regulations describing the limited hours exception (§53.4960-1(d)(3)(v)) accordingly. However, because of changes to the nonexempt funds exception as described later in this Summary of Comments and Explanation of Revisions, these final regulations replace Example 8 (§53.4960-1(d)(3)(viii)) with a new example.

¹ H. Rep. 115-409, 115th Cong., 1st Sess. 333 (Nov. 13, 2017).

² In a similar context, §53.4958-4(a)(2) treats excessive compensation paid to a disqualified person with respect to an applicable tax-exempt organization by a controlled entity of the organization as excessive compensation paid by the organization, and thus as an excess benefit transaction.

c. Nonexempt Funds Exception

As previously discussed, the proposed regulations also provided a “nonexempt funds” exception for employees of a related non-ATEO organization who may perform a large portion of their overall services as an employee of the ATEO under certain circumstances. Under the non-exempt funds exception, an employee is disregarded for purposes of determining an ATEO’s five highest-compensated employees for a taxable year provided that none of the ATEO, any related ATEO, or any controlled taxable related organization, pays the employee of the ATEO any remuneration or grants a legally binding right to nonvested remuneration to the employee. When applying these requirements for the nonexempt funds exception, the ATEO is not treated as paying remuneration that is paid by a related organization that also employs the individual, so long as the ATEO does not reimburse the payor. Further, to prevent indirect payment of remuneration by the ATEO, a related ATEO, or controlled taxable related organization, no related organization that paid remuneration to the individual may provide services for a fee to the ATEO, related ATEO, or any controlled taxable related organization.

To satisfy the nonexempt funds exception, the proposed regulations also stated that the employee must have provided services primarily to a taxable related organization or other non-ATEO (other than a controlled taxable related organization of the ATEO) during the applicable year. For this purpose, an employee is treated as having provided services primarily to the taxable related organization or other non-ATEO (other than a controlled taxable related organization of the ATEO) only if the employee provided services to the taxable related organization or other non-ATEO for more than 50 percent of the employee’s total hours worked for the ATEO and all related organizations (including ATEOs) during the applicable year.

One commenter expressed concern that, for purposes of the nonexempt funds exception, the requirement limiting the employee’s hours worked for the ATEO and all related ATEOs to not more than 50 percent of the total hours worked for the ATEO and all related organizations

during an applicable year was too restrictive and may result in inadvertent failures. The Treasury Department and the IRS acknowledge the issues presented by this comment. These final regulations modify the exception by expanding the measurement period from one applicable year to two applicable years (that is, the current applicable year and the preceding applicable year are treated as a single measurement period) for purposes of determining whether an employee provided services to the ATEO and all related ATEOs for not more than 50 percent of the employee’s total hours worked as an employee of the ATEO and all related organizations during the applicable year and the prior applicable year. This modification provides additional flexibility for situations in which an employee “rotates” to an ATEO for a period that extends longer than six months, or when an employee unexpectedly provides services beyond six months in an applicable year.

Another commenter recommended that the nonexempt funds exception be modified to prohibit the provision of services for a fee to a taxable entity only if the ATEO actually owns a controlling interest in the taxable entity, as opposed to being attributed the ownership interest under the section 318 attribution principles, which were incorporated into the definitions of a related organization and control. The commenter asserted that the related organizations requirement under the proposed nonexempt funds exception (Prop. §53.4960-1(d)(2)(iii)(A)(3)), which incorporates the section 318 attribution principles, is unduly restrictive, and would have unintended results, as illustrated by the following example. An individual who is the sole shareholder of two taxable corporations (Corporation 1 and Corporation 2) also controls an ATEO (by having the power to appoint a majority of the ATEO’s board of directors); Corporation 1 provides administrative services for a fee to Corporation 2; employee of Corporation 1 provides services only to Corporation 1 and does not provide any services to the ATEO. Under these facts, Corporation 2 is deemed to be controlled by the ATEO because, for purposes of determining whether an ATEO controls an organization under Prop. §53.4960-1(i)(2)(vii)(B)(2), if a person controls an ATEO, the ATEO is

treated as owning a percentage of the stock owned by that person in accordance with the percentage of directors of the ATEO that are controlled by that person. Because the related organizations requirement prohibits the payment of a fee by a related organization to a controlled taxable related organization for services performed by an employee of the controlled taxable related organization, and because Corporation 1 is providing services for a fee to Corporation 2, which is deemed to be controlled by the ATEO, no employee of Corporation 1 could meet the requirements of the proposed nonexempt funds exception. The commenter suggested that this result is inappropriate because the sharing of services between two taxable corporations in which an ATEO has no actual ownership interest would not circumvent the legislative intent of section 4960. The Treasury Department and the IRS agree with the commenter’s recommendation. Accordingly, these final regulations modify the attribution rules as they apply for purposes of determining eligibility for the non-exempt funds exception by disregarding the application of downward attribution in applying section 318(a)(3) to corporations and other entities and in applying section 318 principles to nonstock organizations. This modification applies only for purposes of applying the nonexempt funds exception and does not apply for purposes of determining whether an organization is a related organization generally.

d. Limited Services Exception

The proposed regulations provided a “limited services” exception, under which an employee is not considered for purposes of determining an ATEO’s five highest-compensated employees for a taxable year if, during the applicable year, the ATEO paid less than 10 percent of the employee’s total remuneration during the applicable year for services performed as an employee of the ATEO and all related organizations. However, if an employee would not be considered for purposes of determining the five highest-compensated employees of any ATEO in an ATEO’s group of related organizations because no ATEO in the group paid at least 10 percent of the total remuneration paid by the group during the applicable year, then this

exception does not apply to the ATEO that paid the employee the most remuneration during that applicable year. No comments were received on that proposed rule, and these final regulations retain that rule without change.

F. Medical Services

Section 4960(c)(3)(B) provides that remuneration for purposes of section 4960 does not include the portion of any remuneration paid to a licensed medical professional (including a veterinarian) that is for the performance of medical or veterinary services by such professional. Section 4960(c)(5)(C)(iii) provides a substantially similar exception from the definition of “parachute payment.” The proposed regulations provided rules relating to medical services and licensed medical professionals. No comments were received on those rules in the proposed regulations, and these final regulations adopt the rules in the proposed regulations without change. For further discussion of these rules, see section II.F. of the Explanation of Provisions of the proposed regulations, titled “Medical Services.”

These final regulations also adopt the rule in the proposed regulations that a “licensed medical professional” is an individual who is licensed under state or local law to perform medical services. In addition to doctors, nurses, and veterinarians, a licensed medical professional generally would include dentists and nurse practitioners and may include other medical professionals, depending on the applicable state or local law. For a discussion of other issues related to remuneration for medical or veterinary services, including a rule for allocating remuneration received for a combination of medical and non-medical services, see section III.B. of this Summary of Comments and Explanation of Revisions, titled “Remuneration Related to Medical Services.”

G. Predecessor Organization

Section 4960(c)(2)(B) provides that a covered employee includes any employee who was a covered employee of the ATEO

(or any predecessor) for any preceding taxable year beginning after December 31, 2016. Because a covered employee, under section 4960(c)(2), must be (or have been) an employee of an ATEO, the predecessor must also have been an ATEO at the time the individual was employed by the predecessor to be a covered employee. Thus, an individual who is a covered employee of an ATEO (or of an ATEO predecessor of an ATEO) for one taxable year remains a covered employee of that ATEO (and any successor ATEOs) for subsequent taxable years.

The proposed regulations defined “predecessor” by reference to several enumerated categories of organizational changes, including acquisitions, mergers, other reorganizations, and changes in tax-exempt status. A predecessor ATEO ordinarily is an ATEO that has transferred, by any of several legal means, its assets and operations to another pre-existing or newly created ATEO (the successor of the predecessor ATEO). No comments were received with respect to the proposed rules. These final regulations adopt the definition of predecessor as provided in the proposed regulations without change. For further information concerning these rules, see section II.G. of the Explanation of Provisions of the proposed regulations, titled “Predecessor Organization.”

H. Related Organization

Section 4960(c)(4)(A) provides that remuneration paid to a covered employee by an ATEO includes any remuneration paid with respect to employment of the employee by any related person or governmental entity,³ and includes in the definition of “remuneration” any remuneration paid by the employer ATEO, related ATEOs, and related non-ATEOs (including taxable entities, nonprofit entities that are not ATEOs, and governmental entities that are not ATEOs). Section 4960(c)(4)(B) defines a “related organization” of an ATEO as a person or governmental entity that controls, or is controlled by, the ATEO; is controlled by one or more persons that control the ATEO; is a supporting organization or a supporting organiza-

tion (as defined in sections 509(f)(3) and 509(a)(3), respectively) during the taxable year of the ATEO, or, in the case of an ATEO that is a voluntary employees’ beneficiary association described in section 501(c)(9) (VEBA), establishes, maintains, or makes contribution to the VEBA.

Section 4960(c)(4) does not define “control” for purposes of identifying related organizations. To determine which persons are related organizations under section 4960(c)(4)(B), the proposed regulations generally adopted the definition of “control” set forth in section 512(b)(13)(D) and §1.512(b)-1(l)(4). Section II.H. of the Explanation of Provisions of the proposed regulations, titled “Related Organization,” explained that this standard (and its “greater than 50 percent” threshold) was intended to align the definition of “related organization” for purposes of section 4960 with the definition of “related organization” for purposes of the annual reporting requirements on Form 990, “Return of Organization Exempt From Income Tax,” and with other exempt organization control tests.

One commenter recommended that these final regulations instead define “control” based on the controlled group rules in section 414(b) and (c) and the regulations thereunder, which include an 80 percent control test. The commenter suggested that the section 414(b) and (c) controlled group test was more appropriate for a number of reasons: the purpose of section 414(b) and (c) is to treat related parties as a single employer (the same purpose as section 4960(c)(4)(C)), whereas the purpose of section 512(b)(13) is to tax abusive transactions; the regulations under section 512(b)(13) do not reflect statutory revisions; the control definition under section 512(b)(13) is overinclusive; and using the Form 990 test for control does not reduce administrative burdens because the Form 990 rules for identifying an ATEO’s highest-compensated employees and calculating compensation differ significantly from the section 4960 rules.

These final regulations do not adopt the suggestion in this comment. Instead, these final regulations adopt the rules in the proposed regulations, which align the defini-

³The proposed and final regulations refer to related persons and governmental entities collectively as related organizations.

tion of control with the definition in the Form 990 instructions, which, in turn, is generally based on the section 512(b)(13) standards. The Treasury Department and the IRS have concluded that this definition of control is more appropriate and administrable because the Form 990 control definition and the section 512(b)(13) rules are familiar to and used by exempt organizations. Similarly, an 80 percent control threshold, while used in section 414(b) and (c), as well as in regulations under section 162(m), generally is not a standard used for purposes of tax administration related to exempt organizations, whereas the 50 percent control threshold is a control test familiar to exempt organizations. See, for example, the instructions to Form 990; §§1.509(a)-4(g)(1)(i); 1.509(a)-4(j)(1); 56.4911-7(b); 53.4941(d)-1(b)(5); 53.4943-3(b)(3)(ii); 53.4958-4(a)(2)(ii)(B); and 53.4968-3(b). In addition, section 509(a)(3) supporting organizations and their section 509(f)(3) supported organizations are defined as related organizations under section 4960(c)(4)(B); the adoption of an 80 percent control threshold would be incongruous with the lower standards of control for such organizations under §1.509(a)-4 (particularly in the case of Type III supporting organizations, for which control is not required). Further, the legislative history states that the purpose for enacting section 4960 is to deter “excessive compensation,”⁴ indicating an intent to deter arguably abusive practices, and the Treasury Department and the IRS have determined that use of a higher control threshold would allow potentially abusive compensation arrangements among organizations that are related to a lesser degree.⁵ For these reasons, and the reasons set forth in section II.H. of the Explanation of Provisions of the proposed regulations, titled “Related Organization,” these final regulations adopt the rules regarding the overall definition of “control” in the proposed regulations without change.

To determine control of a nonstock organization, the proposed regulations

provided rules similar to other regulations dealing with control of tax-exempt organizations (§§1.512(b)-1(l)(4)(i)(b), 53.4958-4(a)(2)(ii)(B)(1)(iii), and 1.414(c)-5(b))⁶ that provide that a person is considered to control a nonstock organization under either a “removal power” test or a “representative” test. No comments were received addressing the “removal power” test, and the final regulations adopt these rules from the proposed regulations without change. Comments were received on the “representative” test, and in particular the manner in which the proposed regulations would address certain situations involving “accidental control.”

Under the representative test, a person or governmental entity generally controls a nonstock organization if more than 50 percent of the nonstock organization’s directors or trustees are also trustees, directors, officers, agents, or employees of the person or governmental entity. Unlike the representative test in §§1.512(b)-1(l)(4)(i)(b), 53.4958-4(a)(2)(ii)(B)(1)(iii), and 1.414(c)-5(b), the proposed regulations expressly included an officer of the person or governmental entity as a representative for purposes of determining control of a nonstock organization.

In response to Notice 2019-09, a commenter raised the issue of “accidental control” presented by the representative test in which, for example, control of an organization by an employer may be found because a few lower-level employees of the employer serve on the board of directors of the organization. The proposed regulations addressed this issue by permitting a nonstock organization (or its putative controlling person or governmental entity) to qualify for an exception from control status if the employees of the person or governmental entity that are directors or trustees of the nonstock organization are not trustees, directors, officers, or employees with the powers of a director or officer, of the person or governmental entity and are not acting as representatives of the person or governmental entity in their service with the nonstock organization. A

nonstock organization that relies on this exception must report its reliance on this exception on the applicable Form 990 and provide supporting details.

Another commenter on the proposed regulations stated that compliance with this exception to avoid “accidental control” under the representative test places additional reporting burdens on exempt organizations and recommended that these final regulations remove “employees” altogether from the list of deemed representatives and instead focus the representative test on the actual decision-makers in the organization. The commenter suggested that an expansive list of deemed representatives, including employees, is more justifiable with an 80 percent control threshold. These final regulations do not adopt the commenter’s suggestions. The Treasury Department and the IRS have concluded that a rule that treats as non-officers any employees not defined as officers under the organization’s organizing documents may be subject to abuse because employees frequently function as officers, even if they do not have that title. Further, a rule that treats any employee without the title of officer as a non-officer would be inconsistent with other Code provisions addressing exempt organizations, which generally treat as an officer any person with similar powers. See, for, sections 4946(b)(1), 4955(f)(2)(A), 4958(f)(2), 4965(d)(1), and 4966(d)(3)(A). In addition, an employee of an organization (such as a department head) may serve *ex officio* on the board of another organization, and, in substance, serve in a representative capacity. Similarly, the facts of other arrangements in which an employee serves on another organization’s board may demonstrate that the employee is serving as a representative of the employer. Finally, the percentage threshold of control is not necessarily relevant to the determination of whether the individual is serving in a representative capacity—an employer with less than a specific threshold percentage may still have reasons to have an employee represent its interests

⁴H. Rep. 115-409, *supra*, at 333.

⁵The imposition of excise tax under section 4960 is not determinative as to whether the remuneration paid to the covered employee is excessive or unreasonable compensation for purposes of sections 4941 or 4958. Similarly, there is no presumption, inference, or basis for concluding that remuneration paid to a covered employee that is not subject to excise tax under section 4960 is reasonable compensation for purposes of determining liability for excise tax under sections 4941 or 4958.

⁶See also the representative test in section 4911(f)(2)(B)(i) for determining affiliated organizations.

on another organization's board of directors. For these reasons, these final regulations adopt without change the representative rules in the proposed regulations.

The proposed regulations also addressed the status of foreign organizations as ATEOs, excluding them from ATEO status if described in section 4948(b) and the regulations thereunder. The Treasury Department and the IRS requested comments on whether a foreign related organization described in section 4948(b) should be exempt from tax imposed by section 4960(c)(4)(C) and, if so, whether remuneration paid by such an organization should nonetheless be taken into account for purposes of determining excess remuneration and allocating liability among the ATEO and related organizations that are subject to the excise tax imposed by section 4960. No comments were received on these issues. However, the Treasury Department and the IRS have concluded that it is appropriate to address these issues in these final regulations.

Chapter 42 of the Code applies generally to private foundations and other tax-exempt organizations and the excise taxes in chapter 42 generally are payable by exempt organizations and in some cases by persons associated with them. However, under section 4948(b), sections 507 and 508 and chapter 42 do not apply to a foreign organization that has not received substantial support (other than gross investment income) from United States sources. Section 509(d) defines support for purposes of chapter 42 as including gifts, gross receipts from an activity that is not an unrelated trade or business under section 513, net income from unrelated business activities, gross investment income, tax revenues levied for the benefit of the organization, and the value of services or facilities furnished by a governmental unit without charge—a breadth of items that support a tax-exempt organization. Section 4948(b) is thus concerned with foreign private foundations (including entities treated as private foundations for purposes of chapter 42) and other tax-exempt organizations that have received sufficient support from United States sources

to warrant subsection to taxation and various prohibitions under chapter 42. Therefore, the Treasury Department and the IRS have determined that it is appropriate to exclude from taxation under section 4960 as a related organization any foreign organization that is both described in section 4948(b) and is either exempt from tax under section 501(a)⁷ or a taxable private foundation.⁸ Such organizations excluded from the excise tax imposed by section 4960 are referred to as “section 4948(b) related organizations.”

While chapter 42 taxes are inapplicable to section 4948(b) related organizations, those organizations' activities that otherwise would have resulted in chapter 42 taxes may have other consequences. For example, section 4948(c) in certain circumstances imposes loss of exemption on an exempt organization described in section 4948(b) that engages in activities that would result in chapter 42 taxes for domestic organizations. Therefore, the Treasury Department and the IRS have determined that the remuneration paid to a covered employee of an ATEO by a section 4948(b) related organization must be taken into account by the ATEO and any related organizations subject to the excise tax imposed by section 4960 for purposes of determining an ATEO's (and related organizations') liability under section 4960 and the ATEO's five highest-compensated employees, even though the section 4948(b) related organization is not subject to the excise tax imposed by section 4960 on the excess remuneration that is otherwise allocable to that organization. These final regulations also clarify that for purposes of applying the exclusion from status as an ATEO or a related organization, whether the foreign organization meets the requirements of section 4948(b) is determined at the end of the organization's taxable year.

III. Remuneration

A. In General

Consistent with section 4960(c)(3)(A), the proposed regulations defined

“remuneration” as wages under section 3401(a) (meaning generally amounts subject to Federal income tax withholding), but excluding designated Roth contributions under section 402A(c) and including amounts required to be included in gross income under section 457(f). Remuneration does not include certain retirement benefits, including payments that are contributions to or distributions from a trust described in section 401(a); payments under or to an annuity plan described in section 403(a) at the time of payment; payments described in section 402(h)(1) and (2) if, at the time of the payment, it is reasonable to believe that the employee will be entitled to an exclusion under that section for the payment; payments under an arrangement to which section 408(p) applies; or payments under or to an eligible deferred compensation plan described in section 457(b) and maintained by an eligible employer described in section 457(e)(1)(A) (governmental employer) at the time of payment. See section 3401(a)(12). Remuneration includes a parachute payment, but excess remuneration does not include a parachute payment that is an excess parachute payment. These final regulations adopt these rules provided in the proposed regulations without change.

One commenter recommended that, for purposes of computing the excise tax, section 4960(c)(4)(A) should be interpreted to include only remuneration related to the employment of an employee by an ATEO, which would include remuneration paid by a related person or related governmental entity with respect to an ATEO or by any other third party, but only if the payment related to the employee's employment by the ATEO. The commenter stated that this suggested interpretation would ensure that all remuneration with respect to a covered employee's employment by an ATEO, including remuneration paid by a related organization of an ATEO with respect to services performed for the ATEO, would be included in computing the tax under section 4960(a). The commenter asserted that the suggested interpretation would avoid the unintended result, caused by the proposed regulations, of subjecting

⁷Some types of exempt organizations are limited to domestic organizations, such as section 501(c)(10) fraternal organizations.

⁸A private foundation that loses its exemption under section 501(c)(3) remains a taxable private foundation until its private foundation status is terminated under section 507. See sections 509(b) and 4940(b).

to the excise tax remuneration that is paid by persons who are not ATEOs for an individual's services that are unrelated to an ATEO.

The Treasury Department and the IRS have concluded that the more natural reading of the statute is that remuneration paid to a covered employee of an ATEO includes remuneration paid by a related organization with respect to services performed as an employee for the related organization. In addition, adoption of the commenter's suggestion could raise the potential for abuse because it relies on an ability to identify the specific recipient of services that an employee provides to multiple entities and determine the relative value of the services or allocate the compensation to the entities under a reasonable allocation method. Specifically, given the facts and circumstances analysis that in many cases may be difficult and burdensome to administer, adoption of the suggestion could provide an opening for related taxpayers to coordinate their activities to mischaracterize the employer of an individual with respect to some or all services provided to a related organization, or to misallocate portions of the total remuneration paid by the related taxpayers to the individual as paid for services provided as an employee of a related organization, so that all the related entities avoid any liability under section 4960 while still providing what would otherwise be excess remuneration to the individual as an employee of an ATEO. While this type of identification and allocation may be needed for other tax purposes, including in some cases the allocation of liability under section 4960, those applications do not involve a situation such as this in which all the entities may benefit from the mischaracterizations through the avoidance of the potential liability. Thus, the interpretation provided in these final regulations also is consistent with the exercise of authority in section 4960(d) to prevent avoidance of the tax imposed by section 4960 by providing compensation through a third party. Further, adoption of the commenter's suggestion could raise issues regarding the role of section 4960(c)(6), the statutory provision coordinating the application of section 162(m) and section 4960, given the impact that adoption of the suggestion would have on the scope

of circumstances to which that provision may apply. For these reasons, these final regulations do not limit the application of section 4960(c)(4)(A) to remuneration paid solely with respect to employment by an ATEO or for services provided to an ATEO, as suggested by the commenter.

The commenter also suggested that these final regulations not treat remuneration paid by a related organization as paid by the ATEO if a covered employee is not employed by an ATEO at any time during an applicable year. For example, in circumstances in which a covered employee of an ATEO performs services for a related non-ATEO but provides no services for the ATEO during an applicable year, the commenter suggested that compensation for those services not be treated as remuneration under section 4960. These final regulations do not adopt this suggestion. Section 4960(c)(2)(B) provides that once an individual is a covered employee of an ATEO (or any predecessor), the employee remains a covered employee for all subsequent years. Section 4960(c)(4)(A) provides that "remuneration of a covered employee by an [ATEO]" includes "any remuneration paid with respect to employment of such employee by any related person or governmental entity." The Treasury Department and the IRS have concluded that the better interpretation of section 4960(c)(2)(B) and (c)(4)(A), when read together, is that compensation paid to a covered employee by a related organization during an applicable year is remuneration for purposes of section 4960, even if the covered employee does not perform services as an employee of the ATEO during the applicable year. In addition, the commenter's suggestion also raises administrability issues similar to those that would arise if only remuneration for services provided to the ATEO were taken into account. If an employee provides services to different members of a group of related organizations from year to year, it may be difficult to determine what remuneration is allocable to services provided to each group member. Therefore, the commenter's suggestion would be similarly difficult and burdensome to administer and could raise the potential for abuse.

The same commenter also suggested that these final regulations apply the sub-

stance of the limited hours and nonexempt funds exceptions for purposes of determining remuneration paid. These final regulations do not adopt this suggestion because the Treasury Department and the IRS have concluded that the statute does not provide the authority to apply these exceptions to the definition of remuneration. The statute does not define compensation for purposes of identifying the five highest-compensated employees, and thus the statute permits flexibility in the rules for determining the five highest-compensated employees. In contrast, section 4960(c)(3)(A) defines remuneration as wages within the meaning of section 3401(a) (with certain specified modifications) paid by an ATEO and section 4960(c)(4)(A) provides that "remuneration of a covered employee by an [ATEO] shall include any remuneration paid with respect to employment of such employee by any related person or governmental entity." These statutory provisions do not provide the flexibility to adopt the commenter's suggestion to include the exceptions applicable to the determination of a covered employee in the definition of remuneration.

Another commenter requested that these final regulations limit the scope of the definition of remuneration to include only regular employee wages, as defined in section 3401(a), and to exclude taxable fringe benefits from the section 4960 definition of remuneration. The commenter asserted that certain taxable fringe benefits, such as paid parking above the excludable limit and reimbursement of childcare expenses, are not the type of remuneration that was intended to be taxed under section 4960. The commenter further suggested that the inclusion of taxable fringe benefits in remuneration would have an adverse effect on certain employers' ability to attract and retain key employees. These final regulations do not adopt this commenter's suggestion because it would be inconsistent with the statutory provisions. Section 4960(c)(3)(A) defines remuneration as amounts that are "wages" within the meaning of section 3401(a). Section 3401(a) defines "wages" as all remuneration for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash, with certain specific exclusions. Taxable

fringe benefits, including parking above the excludable limit and reimbursement of childcare expenses, are not excluded from wages under section 3401(a). In addition, section 4960(c)(3) specifically excludes other type of wages, such as designated Roth contributions and remuneration for medical services, indicating a legislative intent for all other types of wages to be included. For these reasons, the Treasury Department and the IRS have determined that providing further exclusions such as those suggested would be inconsistent with the statute and these final regulations do not adopt this suggestion.

The proposed regulations clarified that remuneration includes any amount includible in gross income as compensation under section 7872 and the regulations thereunder. For example, under §1.7872-15(e)(1)(i), a below-market split-dollar loan between an employer and employee generally is treated as a compensation-related loan, and thus any imputed transfer from the employer to the employee generally is a payment of compensation. Although section 7872(f)(9) provides that no amount shall be withheld under chapter 24 of the Code with respect to any amount treated as transferred or retransferred under section 7872(a) or received under section 7872(b), those amounts are “remuneration ... for services performed by an employee for his employer” within the meaning of section 3401(a) and are not specifically excluded from wages under section 3401(a). Thus, those amounts are remuneration as defined in section 4960(c)(3)(A). ATEOs that are private foundations or section 509(a)(3) supporting organizations should consider, before entering into these arrangements, that loans (including transactions treated as loans for Federal tax purposes, such as split-dollar arrangements) to certain employees may constitute an act of self-dealing under section 4941 or an excess benefit transaction under section 4958(c)(3).

A commenter recommended that these final regulations, or alternatively the preamble to these final regulations, confirm that remuneration does not include amounts that are not includible in gross income pursuant to the \$10,000 de minimis exception under section 7872(c)(3). Under that exception, the foregone interest attributable to any day on which

the aggregate outstanding amount of loans between the borrower and lender does not exceed \$10,000 is not includible in gross income. These final regulations adopt the commenter’s suggestion and clarify that, in accordance with section 7872, these de minimis amounts are not remuneration for purposes of section 4960. Other than this comment that resulted in this clarification, no further comments were received on those provisions of the proposed regulations, and these final regulations adopt them without further changes.

B. Remuneration Related to Medical Services

Remuneration that is paid to a licensed medical professional for medical services is excluded from the definition of “remuneration” for purposes of section 4960. (See section II.F. of the Summary of Comments and Explanation of Revisions, titled “Medical Services,” for a further discussion of the scope of this exception.) When an employer pays remuneration to an employee for both medical services (including related services, such as medical recordkeeping) and other services, the employer must allocate that remuneration between remuneration paid for medical services or for other services. These final regulations adopt the proposed regulations, with minor clarifications, and permit taxpayers to use a reasonable, good faith method to allocate remuneration between these two categories of services. For this purpose, taxpayers may rely on a reasonable allocation set forth in an employment agreement allocating remuneration between medical services and other services. If some or all of the remuneration is not reasonably allocated in an employment agreement, taxpayers must use another reasonable method of allocation. For example, allocating remuneration to medical services based on the portion of the total hours the employee worked for the employer providing medical services (determined based on records such as patient, insurance, Medicare/Medicaid billing records, or internal time reporting mechanisms) would be a reasonable method.

In section III.B. of the Explanation of Provisions of the proposed regulations,

titled “Remuneration Related to Medical Services,” the Treasury Department and the IRS requested comments on other reasonable methods of allocating remuneration between medical services and other services. One commenter recommended that an employer be permitted to make a reasonable, good faith allocation between remuneration for providing medical services and remuneration for providing non-medical services, not only with respect to current remuneration but also with respect to contributions and earnings under a deferred compensation plan. These final regulations adopt this recommendation and clarify that an employer may make a reasonable, good faith allocation between remuneration for medical and nonmedical services, regardless of the form of compensation, and that an employer may apply the same principles with respect to contributions and earnings under a deferred compensation plan.

C. When Remuneration Is Treated as Paid

The proposed regulations addressed when remuneration is treated as paid for purposes of section 4960. The flush language at the end of section 4960(a) provides that, for purposes of section 4960(a), remuneration is treated as paid when there is no substantial risk of forfeiture of the rights to the remuneration within the meaning of section 457(f)(3)(B). Although section 4960(a) cross-references the definition of “substantial risk of forfeiture” in section 457(f)(3)(B), the rule under section 4960(a) providing that remuneration is treated as paid when there is no substantial risk of forfeiture of the rights to the remuneration is neither limited to remuneration that is otherwise subject to section 457(f) nor limited to amounts paid pursuant to a nonqualified deferred compensation arrangement. The proposed regulations provided that, for purposes of section 4960(a), all forms of remuneration except for “regular wages” as described in the next paragraph are treated as paid when the remuneration is not subject to a substantial risk of forfeiture. These final regulations adopt this payment timing rule provided in the proposed regulations with certain modifications, as discussed in further detail in this section.

To clarify when remuneration that is never subject to a substantial risk of forfeiture is treated as paid, the proposed regulations provided that remuneration that is a “regular wage” within the meaning of §31.3402(g)-1(a)(ii) is treated as paid at the time of actual or constructive payment. A “regular wage” is defined in §31.3402(g)-1(a)(ii) as remuneration “paid at a regular hourly, daily, or similar periodic rate (and not an overtime rate) for the current payroll period or at a predetermined fixed determinable amount for the current payroll period.” These final regulations adopt these rules provided in the proposed regulations without change. Because the final regulations provide that remuneration that is a regular wage within the meaning of §31.3402(g)-1(a)(ii) is treated as paid when actually or constructively paid, an employer will not need to determine amounts of regular wages that vested in the preceding year for purposes of section 4960. For example, if a pay period begins December 25, 2022, and ends January 7, 2023, and the salary for that period is not actually paid until January 14, 2023, then the salary for the pay period is treated as paid in 2023, and the employer need not treat any amount as remuneration paid in 2022 due to vesting in 2022.

The proposed regulations treated an amount that is not regular wages as paid when it is no longer subject to a substantial risk of forfeiture within the meaning of section 457(f)(3)(B) and referred to such an amount as “vested.” The Treasury Department and the IRS issued proposed regulations under section 457(f) in 2016 (81 FR 40548 (June 22, 2016)), upon which taxpayers may rely for periods before the applicability date of the final section 457(f) regulations. Under Prop. §1.457-12(e)(1), an amount of compensation is subject to a substantial risk of forfeiture only if entitlement to the amount is conditioned on the future performance of substantial services, or upon the occurrence of a condition that is related to a purpose of the compensation if the possibility of forfeiture is substantial. See Prop. §1.457-12(e)(3) for examples of the rules relating to substantial risk forfeiture. These final regulations adopt the rules provided in the proposed regulations, including the defi-

nition of “substantial risk of forfeiture” in Prop. §1.457-12(e)(1). Any changes to the proposed regulations under section 457(f) when finalized will be considered for purposes of section 4960, and further guidance may be issued, if appropriate, including any transition guidance that may be needed to take into account periods before and after the applicability date of the definition of substantial risk of forfeiture under the final section 457(f) regulations.

In section III.C. of the Explanation of Provisions of the proposed regulations, titled “When Remuneration Is Treated as Paid,” the Treasury Department and the IRS invited comments regarding any burdens that could be avoided through a short-term deferral rule and how such a rule could be designed to avoid permitting inappropriate avoidance of the tax. One commenter recommended that these final regulations extend the rule for “regular wages” as defined in §31.3402(g)-1(a) to amounts that are not treated as deferred compensation under §1.409A-1(b)(4) or Prop. §1.457-12(d)(2) because such amounts are paid within the “short-term deferral” period. The commenter suggested that other remuneration that falls outside the definition of “regular wages” be treated as remuneration when actually or constructively paid, including benefits under bona fide severance pay plans and death and disability plans, as well as annual bonuses, long-term incentive pay, business expense reimbursements, and noncash fringe benefits. The commenter noted that such amounts are treated as wages for other reporting purposes, including Federal Insurance Contributions Act (FICA) wage reporting, when actually or constructively paid, and thus the rules under the proposed regulations result in a timing mismatch. The commenter asserted that this recommendation would substantially reduce the administrative burden and potential for errors created by the broad timing rule in the proposed regulations, yet affect a limited range of remuneration.

Another commenter recommended that these final regulations provide that the short-term deferral exception to the definition of deferred compensation for section 457(f) apply to section 4960 such that the year of inclusion for in-

come tax purposes matches the year of inclusion for section 4960 purposes. The commenter interpreted the statutory reference to wages under section 3401(a) and amounts included in income under section 457(f) as providing not only a substantive rule but also a timing rule, meaning the amount must either be wages within the meaning of section 3401(a) paid during that year or be an amount included in income under section 457(f) during that year in order to be treated as remuneration paid in that year. According to the commenter, since amounts that meet the definition of a short-term deferral for purposes of section 457(f) are neither wages under section 3401(a) nor includible in income under section 457(f) in the year of vesting, those amounts should be treated as remuneration for purposes of section 4960 only in the year actually paid.

Further, the commenter noted that applying a short-term deferral rule would simplify administration for employers because the determination of remuneration would more closely track the determination of wages for Form W-2, “Wage and Tax Statement,” reporting. The commenter acknowledged the concern stated in section III.C. of the Explanation of Provisions of the proposed regulations, titled “When Remuneration Is Treated as Paid,” that a short-term deferral rule would permit an ATEO to select the year in which remuneration would be subject to tax under section 4960, but observed that an individual may become a covered employee during the section 457(f) short-term deferral period after the year of vesting, and thus the proposed rule could actually result in amounts not being subject to the excise tax. The commenter also observed that treating short-term deferrals as remuneration in the year of vesting requires that those amounts be present-valued and that earnings be included in remuneration in the subsequent year, resulting in additional complexity for ATEOs. Finally, the commenter suggested that an employer be permitted to include an amount in remuneration in the year of vesting or include the amount in the year of payment, as is permitted for FICA tax purposes under §31.3121(v)(2)-1(b)(3)(iii), and require that employers apply consistent treatment of amounts

with respect to its selection of the timing of FICA taxation of short-term deferrals and timing of the treatment as remuneration for purposes of section 4960.

These final regulations do not adopt the commenter's suggestions to apply a "short-term deferral" rule. Rather, these final regulations adopt the applicable provisions of the proposed regulations without change. Under section 4960(c)(3), an amount must either be wages under section 3401(a) or be includible in income under section 457(f) in order to be remuneration under section 4960. However, the rules under section 4960(c)(3) determine whether an amount is remuneration, not when the remuneration is considered to be paid. The flush language at the end of section 4960(a) provides that, for purposes of section 4960(a), remuneration is treated as paid when there is no substantial risk of forfeiture, as defined in section 457(f)(3)(B), of the rights to the remuneration. Section 3401(a) primarily focuses on whether, not when, amounts are includible in wages; the basic timing rule for wage inclusion appears in regulations under section 3402(a), not section 3401(a). Specifically, §31.3402(a)-1(b) provides that wages are paid when actually or constructively paid and explains what it means for an amount to be constructively paid. Thus, the cross-reference to section 3401(a) (and not section 3402(a)) in section 4960(c)(3) establishes the scope of the term "remuneration" without regard to timing, but the flush language in section 4960(a) establishes the timing rule that applies to all forms of remuneration. In addition to being inconsistent with the statutory language addressing the timing of the payment of remuneration, allowing a short-term deferral rule similar to the rule in §1.409A-1(b)(4) and Prop. §1.457-12(d)(2) could permit an employer to determine the taxable year in which the amount is treated as paid, which could be used not only to manipulate the application of section 4960(a) to the remuneration paid, but also to manipulate the identification of covered employees.

This application of the statutory language results in circumstances in which the amount of remuneration paid for purposes of section 4960 is not the same as the amount reported in any box on Form W-2 for an applicable year. However, as

described later in this section, these final regulations address the administrative burden of calculating the present value of vested but unpaid amounts by expanding the ability to include at vesting the full amount that is to be paid in circumstances in which there is a short delay between vesting and payment.

These final regulations adopt the rule set forth in the proposed regulations that provided that an amount of remuneration treated as paid generally is the present value of the remuneration on the date on which the covered employee vests in the right to payment of the remuneration. The employer must determine the present value using reasonable actuarial assumptions regarding the amount, time, and probability that the payment will be made. These final regulations do not provide rules for the determination of present value. However, an employer may determine the present value using the rules set forth in Prop. §1.457-12(c)(1). The Treasury Department and the IRS anticipate that final regulations addressing the determination of present value for purposes of section 4960 will be issued when final regulations under section 457(f) are issued. Until actually or constructively paid or otherwise includible in gross income of the employee, any amount treated as paid at vesting is referred to as "previously paid remuneration."

To reduce the administrative burden of determining the present value of remuneration in certain circumstances that would involve minimal discounting, these final regulations adopt the rule provided in the proposed regulations that the employer may treat the entire amount to be paid on a future date (without making a present valuation determination) as the present value on the date of vesting. However, these final regulations do not limit the application of this rule to amounts that are paid under a nonaccount balance plan described in §1.409A-1(c)(2)(i)(C), but instead this rule applies to any vested amount that is scheduled to be paid within 90 days. For example, an employer is not required to discount an annual bonus of \$10,000 that vests on December 31, 2022, and is scheduled to be paid on February 15, 2023, to reflect the delay in actual payment, but instead may treat \$10,000 as remuneration paid in 2022.

D. Earnings and Losses

These final regulations generally adopt the proposed regulations and provide specific rules for the treatment of earnings and losses on previously paid remuneration. In general, these rules are intended to minimize administrative burdens in determining the amount of earnings and losses treated as paid for an applicable year, as well as in determining the amount of earnings and losses across multiple compensation arrangements.

The proposed regulations provided that net earnings on previously paid remuneration are treated as vested (and therefore paid) on the last day of the applicable year in which they are accrued unless otherwise actually or constructively paid before that date. For example, the present value of vested remuneration accrued to an employee's account under an account balance plan described in §1.409A-1(c)(2)(i)(A) (under which the earnings and losses attributed to the account are based solely on a predetermined actual investment or a reasonable market interest rate) is treated as paid on the date accrued to the employee's account and, until subsequently actually or constructively paid, is treated as previously paid remuneration. In addition, at the end of each applicable year in which there is previously paid remuneration remaining in the covered employee's account balance, the present value of any net earnings accrued on that previously paid remuneration (the increase in present value due to the application of a predetermined actual investment or a reasonable market interest rate) is treated as remuneration paid in that applicable year. This remuneration is then treated as previously paid remuneration for subsequent applicable years until actually or constructively paid.

Similarly, the proposed regulations provided that the present value of a vested, fixed amount of remuneration under a nonaccount balance plan described in §1.409A-1(c)(2)(i)(C) is treated as paid on the date of vesting and subsequently treated as previously paid remuneration until actually or constructively paid. In addition, at the end of each applicable year in which previously paid remuneration remains as part of the covered employee's benefit under the plan, the

net increase in the present value of that amount during the year due solely to the passage of time constitutes earnings and is treated as remuneration paid. For this purpose, earnings and losses from one plan or arrangement are aggregated with earnings and losses from any other plan or arrangement in which the employee participates that is provided by the same employer (but not across arrangements provided by related but separate employers). For purposes of determining earnings and losses, previously paid remuneration under a plan or arrangement is reduced by the amount actually or constructively paid under the plan or arrangement. These final regulations further illustrate the operation of these rules through examples.

One commenter recommended that these final regulations permit, but not require, related employers to determine net earnings on previously paid remuneration on an aggregate basis by treating all earnings and losses on the previously paid remuneration of related employers as paid by the ATEO. The commenter explained that in groups of related taxable and tax-exempt organizations, related organizations often provide separate deferred compensation plans to their employees. Therefore, an individual employee who works (or has worked) for multiple related employers might have several deferred compensation plans, which often differ considerably, with some being nonaccount balance plans and others being account balance plans that may offer very different investment options. As a result, an individual employee might accrue significant earnings in a year under some deferred compensation plans but incur significant losses in others. The commenter therefore suggested that these final regulations permit aggregation of losses with earnings among related employers to avoid the inappropriate inflation of remuneration in certain circumstances. Any concerns about manipulation due to permitting aggregation could be addressed by requiring employers to aggregate (or not aggregate) earnings and losses consistently from year to year, with changes allowed only infrequently—for example, every 3 years—unless in response to changes in the composition of the group of related organizations.

These final regulations do not adopt the commenter's suggestion to permit the aggregation of earnings and losses among related organizations. The commenter's suggestions would be feasible among related organizations only if they agreed to either aggregate or disaggregate arrangements as to all employees and also to coordinate and integrate their remuneration calculations across the separate plans and arrangements that each employer established to permit timely and accurate calculations for each covered employee (and employees that may become covered employees) who participated in more than one employer arrangement. Even if this was feasible for a particular year, the regulatory framework would need to account for the entry and departure of members of the group of related organizations and how the aggregation or disaggregation would account for those events. This regime would be complex and burdensome for taxpayers and the IRS to administer and is not warranted due to the limited potential benefits. In addition, the aggregation of earnings and losses across related employers would implicate the statutory allocation of the liability for the tax on excess remuneration under section 4960(c)(4)(C), since the aggregation of earnings and losses would impact the relative remuneration paid by the separate employers.

E. Request for a Grandfathering Rule

One commenter suggested that these final regulations provide for grandfathering of employee remuneration contracts executed on or before November 2, 2017, so that amounts paid under such contracts would not be treated as remuneration for purposes of section 4960. The commenter reasoned that the grandfathering of employee remuneration contracts executed on or before November 2, 2017, would help certain employers in overcoming challenges in hiring executives, and that the legislative history of the TCJA failed to consider the differences between tax-exempt employers and their taxable counterparts. The final regulations do not adopt the commenter's suggested rule. Section 13602(c) of TCJA, which added section 4960 to the Code, did not provide for a grandfathering rule and there is no

indication in the legislative history that Congress intended that one be adopted by regulation. In contrast, section 13601 of TCJA amended section 162(m) of the Code and provided an explicit grandfathering rule. Under these circumstances, the Treasury Department and the IRS do not find it appropriate to provide a grandfathering rule. However, these final regulations provide rules that have the effect of grandfathering remuneration that vested before the taxpayer's first taxable year beginning after December 31, 2017.

Section III.E. of the Explanation of Provisions of the proposed regulations, titled "Request for a Grandfather Rule," explained that one of the consequences of treating remuneration as paid at the time the remuneration vests is that any remuneration that vested prior to the first day of the first taxable year of the ATEO beginning after December 31, 2017, is not considered remuneration for purposes of section 4960. One commenter recommended that the Treasury Department and the IRS explicitly reflect this rule in these final regulations. In response to this comment, these final regulations provide that any vested remuneration, including vested but unpaid earnings accrued on deferred amounts, that is treated as paid before the effective date of section 4960 (January 1, 2018, for a calendar year employer) is not subject to the excise tax imposed under section 4960(a)(1). All earnings on those vested amounts that accrue or vest after the effective date, however, are treated as remuneration paid for purposes of section 4960(a)(1).

Similarly, for an employee who has vested compensation from years prior to the taxable year in which the employee first became a covered employee, these final regulations adopt the rule in the proposed regulations providing that vested remuneration (including vested but unpaid earnings) that would have been treated as remuneration paid for a taxable year before the taxable year in which an employee first became a covered employee under section 4960 is not remuneration subject to the excise tax imposed by section 4960(a)(1) for the first taxable year in which the employee becomes a covered employee or any subsequent year. However, subsequent earnings that accrue on those vested amounts when the employee is a covered

employee are treated as remuneration paid for purposes of section 4960(a)(1).

F. Remuneration Paid to a Covered Employee for Which a Deduction Is Disallowed Under Section 162(m)

Section 4960(c)(6) provides that remuneration for which a deduction is disallowed under section 162(m) is not taken into account for purposes of section 4960. Thus, remuneration that is paid to a covered employee of an ATEO who is also a covered employee of a related “publicly held corporation” or an applicable individual of a related “covered health insurance provider” (as defined in section 162(m)(2) and (m)(6) (C), respectively), for which a deduction is disallowed under section 162(m), generally is not treated as remuneration for purposes of determining whether remuneration has been paid. However, that remuneration is taken into account for purposes of determining the ATEO’s five highest-compensated employees. See section II.E. of this Summary of Comments and Explanation of Revisions, titled “Covered Employee.”

As discussed in section III.F. of the Explanation of Provisions of the proposed regulations, titled “Remuneration Paid to a Covered Employee for Which a Deduction Is Disallowed Under Section 162(m),” the application of this provision raises significant issues stemming largely from the difference in timing between the payment of remuneration under section 4960 (when the right to the amount vests), and the availability of a deduction that may be restricted by section 162(m) (generally when the amount is paid). Section III.F. of the Explanation of Provisions of the proposed regulations, titled “Remuneration Paid to a Covered Employee for Which a Deduction Is Disallowed Under Section 162(m),” described two possible approaches for addressing these circumstances and requested comments on those approaches. The Treasury Department and the IRS continue to consider the issues raised by this provision in section 4960(c)(6) requiring coordination with section 162(m), including the comments submitted, but have not yet determined the appropriate manner of implementation. Accordingly, these final

regulations do not address the coordination of sections 4960 and 162(m) in these circumstances, but instead reserve a section of these final regulations as a place for future guidance.

Until that future guidance is issued, taxpayers may use a reasonable, good faith approach with respect to the coordination of sections 4960 and 162(m) in circumstances in which it is not known whether a deduction for the remuneration will be disallowed under section 162(m) by the due date (including any extension) of the relevant Form 4720. For this purpose, a reasonable, good faith approach must have a reasonable basis for anticipating that the compensation that a particular employee will be paid in the future may be subject to the deduction limitations of section 162(m). For example, it is not reasonable for this purpose to anticipate that an ATEO may become a public corporation by the date the compensation will be paid absent facts indicating that is a realistic potentiality. Additionally, until further guidance is issued, the two approaches regarding deferred compensation described in section III.F. of the Explanation of Provisions of the proposed regulations, titled “Remuneration Paid to a Covered Employee for Which a Deduction Is Disallowed Under Section 162(m),” will be treated as reasonable, good faith approaches. However, a third approach suggested by a commenter, under which section 162(m) would not disallow a taxpayer’s deduction for remuneration that the taxpayer treated as excess remuneration under section 4960 in a previous taxable year, will not be treated as a reasonable, good faith approach, because such an approach would be inconsistent with section 162(m) and the regulations thereunder.

IV. Excess Remuneration

In general, the excise tax imposed under section 4960(a)(1) is based on the remuneration paid (other than any excess parachute payment) by an ATEO for the taxable year with respect to employment of any covered employee in excess of \$1 million. Consistent with the proposed regulations, these final regulations refer to this amount as “excess remuneration.” The \$1 million threshold provided in section 4960(a)(1) is not adjusted for infla-

tion, and an amount subject to tax under section 4960(a)(2) as an excess parachute payment is not subject to tax under section 4960(a)(1) as excess remuneration.

As provided in section 4960(c)(4)(C), if an individual performs services as an employee for two or more related organizations during an applicable year, one or more of which is an ATEO, each employer is liable for its proportionate share of the excise tax. These final regulations adopt the rules provided in the proposed regulations for allocating liability for the excise tax among the employers. For this purpose, remuneration that is paid by a separate organization (whether related to the ATEO or not) for services performed as an employee of the ATEO is treated as remuneration paid by the ATEO. For a further discussion of when amounts are treated as paid by an ATEO, see section VI of this Summary of Comments and Explanation of Revisions, titled “Calculation, Reporting, and Payment of the Tax.”

V. Excess Parachute Payments

A. In General

The proposed regulations set forth rules with respect to excess parachute payments under section 4960. No comments were received on these rules, and these final regulations adopt them without change. Section 4960(a)(2) imposes an excise tax on any excess parachute payment. Section 4960(c)(5)(A) provides that “excess parachute payment” means an amount equal to the excess of any parachute payment over the portion of the base amount allocated to such payment. Section 4960(c)(5)(B) provides that “parachute payment” means any payment in the nature of compensation to (or for the benefit of) a covered employee if the payment is contingent on the employee’s separation from employment with the employer and the aggregate present value of the payments in the nature of compensation to (or for the benefit of) the individual that are contingent on the separation equals or exceeds an amount equal to 3-times the base amount. Under section 4960(c)(5)(C), certain retirement plan payments, certain payments to licensed medical professionals, and payments to an individual who is not a “highly compensated employee” (HCE) as defined in

section 414(q) are not excess parachute payments.⁹

The excess parachute payment rules under section 4960 are modeled after section 280G, but section 4960(c)(5)(B) defines “parachute payment” differently than section 280G(b)(2). The section 4960 definition refers to payments contingent on an employee’s separation from employment, whereas the section 280G definition refers to payments contingent on a change in the ownership or effective control of a corporation (or in the ownership of a substantial portion of the assets of the corporation). While these final regulations incorporate many of the concepts found in the rules under §1.280G-1, with modifications to reflect the statutory differences between sections 280G and 4960, they do not incorporate other rules under §1.280G-1 because those rules address issues that do not arise under section 4960. In addition, many provisions in these final regulations do not have parallel rules under §1.280G-1 because they address issues that arise under section 4960, but not under section 280G.

The following sections provide a general overview of these final regulations for purposes of calculating the excise tax imposed under section 4960(a)(2), noting certain similarities and differences between these final regulations and the rules under §1.280G-1. For more information concerning these rules, including additional similarities and differences with the rules under section 280G, see section V of the Explanation of Provisions of the proposed regulations, titled “Excess Parachute Payments.”

B. Definitions Related to Excess Parachute Payments

These final regulations define “excess parachute payment” and the term “parachute payment” for purposes of section 4960. Any payment in the nature of compensation made by an ATEO (or any predecessor or related organization) to a covered employee that is contingent on the employee’s separation from employment

is taken into account for purposes of the parachute payment calculation, assuming no exclusion applies. Those combined payments constitute a parachute payment if the aggregate present value of all such payments made to an individual equals or exceeds 3-times the individual’s base amount. A parachute payment is an excess parachute payment to the extent it exceeds one-times the individual’s base amount allocated to the payment.

These final regulations define a “payment in the nature of compensation” based on §1.280G-1, Q/A-11 and Q/A-14. In general, any payment arising out of an employment relationship is a payment in the nature of compensation. A payment in the nature of compensation is reduced, however, by any consideration paid by the covered employee in exchange for the payment.

C. Payments Contingent on a Separation from Employment

1. In General

Although section 4960 does not define what it means for a payment to be contingent on a separation from employment, these final regulations generally treat a payment as contingent on an employee’s separation from employment only if there is an involuntary separation from employment. If the payment is subject to a substantial risk of forfeiture (defined in a manner consistent with section 457(f)) that lapses upon an involuntary separation from employment, and the separation causes the risk of forfeiture to lapse, the payment is contingent on separation from employment.

2. Requirement of Involuntary Separation from Employment

Separation from employment (whether voluntary or involuntary) often is used in compensation arrangements as a trigger to pay vested compensation. For example, it is typical for a nonqualified deferred compensation plan to provide that a payment

or a series of payments will be made or begin upon a separation from employment, including separation from employment resulting from death or disability. The vested amounts that are to be paid after a separation from employment generally are not treated as contingent on a separation from employment because the amounts will never be subject to forfeiture or otherwise not paid (even if an employee does not voluntarily or involuntarily terminate employment during the employee’s lifetime, the payments will be made upon the employee’s death). In these cases, the separation from employment functions only as a payment timing event and is neither a contingent event that may not occur nor a precondition to entitlement to the payment.

3. Definition of “Involuntary Separation from Employment”

If an amount is payable solely upon an involuntary separation from employment, then it is a payment contingent on an event that may not occur and that is a precondition to entitlement to the payment. The definition of an “involuntary separation from employment” set forth in these final regulations is modeled after the definition of an “involuntary separation from service” in §1.409A-1(n)(1), which also was the model for the definition of an “involuntary severance from employment” under Prop. §1.457-11(d)(2). A separation from employment for good reason is treated as an involuntary separation from employment for purposes of section 4960 if certain conditions are met. For this purpose, these regulations generally adopt the standards set forth in §1.409A-1(n)(2) and Prop. §1.457-11(d)(2)(ii).

These final regulations generally adopt the standards of the section 409A regulations for purposes of determining whether there has been a separation from employment, except that for purposes of section 4960 a bona fide change from employee to independent contractor status is treated as a separation from employment. Because the section 409A regulations do not

⁹Under section 414(q), a “highly compensated employee” generally is defined as any employee who was a five-percent owner at any time during the year or the preceding year or who had compensation from the employer in the preceding year in excess of an inflation-adjusted amount. Notice 2019-59 (2019-47 I.R.B. 1091) and Notice 2020-79 (2020-46 I.R.B. 1014), provide that the inflation-adjusted amounts for 2020 and 2021 are \$130,000 and \$130,000, respectively. See section 414(q) and the regulations thereunder for additional rules, including the availability of an election to treat no more than the top 20 percent of an employer’s employees as highly compensated employees by reason of their compensation.

provide a standard for determining when an involuntary change of status from employee to independent contractor results in a separation from employment, in section V.C.3. of the Explanation of Provisions of the proposed regulations, titled “Definition of ‘Involuntary Separation from Employment,’” the Treasury Department and the IRS requested comments on whether additional guidance is needed on this issue. No comments were received in response to that request. Consistent with the proposed regulations, these final regulations provide that a separation from employment occurs in the case of a bona fide and involuntary change of status from employee to independent contractor in circumstances in which the change in status otherwise meets the requirements for an involuntary separation from employment.

With respect to when an employee otherwise has terminated employment, these final regulations adopt rules based on the section 409A regulations. Specifically, these regulations adopt the standards of §1.409A-1(h)(1)(ii), providing that an anticipated reduction in the level of services of more than 80 percent is treated as a separation from employment, an anticipated reduction in the level of services of less than 50 percent is not treated as a separation from employment, and the treatment of an anticipated reduction between these two levels will depend on the facts and circumstances. The measurement of the anticipated reduction in the level of services is based on the average level of bona fide services performed over the immediately preceding 3 years (or shorter period for an employee employed for less than 3 full prior years). However, these regulations do not adopt the rule in §1.409A-1(h)(1)(ii), under which an employer may modify the level of the anticipated reduction in future services that will be considered to result in a separation from employment.

4. When a Payment Is Contingent on Separation from Employment

In defining when a payment is contingent on separation from employment, these final regulations do not focus solely on whether the payment would not have been made but for a separation from employment, but also take into consideration whether the separation from employment

accelerates the right to payment or the lapse of a substantial risk of forfeiture with respect to the right to payment. Generally, if the payment or the lapse of a substantial risk of forfeiture is accelerated as a result of an involuntary separation from employment (such as a payment that otherwise would have vested and been paid had the employee remained employed for a subsequent period), then the value of any accelerated payment plus the value of any lapse of the substantial risk of forfeiture is treated as contingent on a separation from employment (since the employer would not have provided the increased value in the absence of an involuntary separation from employment).

However, if the lapse of the substantial risk of forfeiture is dependent on an event other than the performance of services, such as the attainment of a performance goal, and if that event does not occur prior to the employee’s separation from employment, but the payment vests due to the employee’s involuntary separation from employment, then the full amount of the payment is treated as contingent on the separation from employment.

As discussed in section V.C.4. of the Explanation of Provisions of the proposed regulations, titled “When a Payment Is Contingent on Separation from Employment,” a payment the right to which is not subject to a substantial risk of forfeiture within the meaning of section 457(f)(3)(B) at the time of an involuntary separation from employment generally is not contingent on a separation from employment (since the right to the payment is not triggered by the separation from employment). However, the increased value of a payment accelerated due to the involuntary separation from employment, and the value of accelerated vesting due to the involuntary separation from employment, each generally are treated as a payment contingent on a separation from employment. In addition, a payment for damages due to the breach of an employment agreement that is related to an involuntary separation from employment generally constitutes a payment contingent on a separation from employment, and a payment for compliance with a noncompetition agreement or similar arrangement may, in certain situations, constitute a payment contingent on a separation from employment.

Actual or constructive payment of an amount that was previously includible in gross income is not a payment contingent on a separation from employment. For example, a payment of deferred compensation after an involuntary separation from employment that vested based on years of service completed before the involuntary separation from employment generally is not a payment that is contingent on a separation from employment because the separation from employment may affect the time of, but not the right to, the payment (although the value of an acceleration of the payment may be contingent on a separation from employment).

Unlike Q/A-25 and Q/A-26 of §1.280G-1, these regulations do not provide a presumption that a payment made pursuant to an agreement entered into or modified within 12 months of a separation from employment is a payment that is contingent on a separation from employment. However, as discussed later in this section, if the facts and circumstances demonstrate that either the vesting or the payment of an amount would not have occurred but for the involuntary nature of the separation from employment, the amount will be treated as a payment contingent on a separation from employment.

In addition, these final regulations do not provide a rule similar to §1.280G-1, Q/A-9 (exempting reasonable compensation for services rendered on or after a change in ownership or control from the definition of “parachute payment”), which would exclude reasonable compensation for services provided after a separation from employment. In most cases, the issue of whether payments made after a separation from employment are reasonable compensation for services will not arise because the employee will not provide services after the separation from employment. However, if the employee continues to provide services (including as a bona fide independent contractor) after an involuntary separation from employment, payments for those services are not contingent on the involuntary separation from employment to the extent those payments are reasonable and are not made due to the involuntary nature of the separation from employment.

Notwithstanding the foregoing, if the facts and circumstances demonstrate that

either vesting or payment of an amount (whether before or after an involuntary separation from employment) would not have occurred but for the involuntary nature of the separation from employment, the amount will be treated as contingent on a separation from employment. For example, an employer's exercise of discretion to accelerate vesting of an amount shortly before an involuntary separation from employment may indicate that the acceleration of vesting was due to the involuntary nature of the separation from employment and was therefore contingent on the employee's separation from employment.

In section V.C.4. of the Explanation of Provisions of the proposed regulations, titled "When a Payment Is Contingent on Separation from Employment," the Treasury Department and the IRS requested comments on whether there are additional types of payments made in connection with separation from employment and the extent to which these final regulations under section 4960 should be modified to ensure appropriate classification of those payments as contingent or not contingent on separation from employment. No comments were received in response to this request, and no modifications have been made in the final regulations.

D. Three-Times-Base-Amount Test

Section 4960(c)(5) provides rules for determining the tax on any excess parachute payment imposed under section 4960(a)(2). Section 4960(c)(5)(B) provides that a payment is a parachute payment only if the aggregate present value of the payments in the nature of compensation to (or for the benefit of) an individual that are contingent on a separation from employment equals or exceeds an amount equal to 3-times the base amount. Section 4960(c)(5)(D) provides that rules similar to the rules of section 280G(b)(3) apply for purposes of determining the base amount, and section 4960(c)(5)(E) provides that rules similar to the rules of section 280G(d)(3) and (4) apply for purposes of present value determinations. Section 280G(b)(3) provides that "base

amount" means an individual's annualized includible compensation for the base period. Section 280G(d)(2) defines "base period" as the period consisting of the 5 most-recent taxable years of the service provider ending before the date on which the change in ownership or control occurs or the portion of such period during which the individual performed personal services for the corporation.

These final regulations provide that the "base amount" is the average annual compensation as an employee of the ATEO (including services performed as an employee of a predecessor or related organization) for the taxable years in the "base period." The base period is the 5 most-recent taxable years during which the individual was an employee of the ATEO (or predecessor or related organization) or the portion of the 5-year period during which the employee was an employee of the ATEO (or predecessor or related organization).

These final regulations provide rules for determining whether a payment is an excess parachute payment, including rules for applying the 3-times-base-amount test. The rules for determining the base amount, base period, and present value, including determining the present value of payments that are contingent on uncertain future events, are based on the rules under §1.280G-1, Q/A-30 through Q/A-36 (substituting an involuntary separation from employment for a change in control). These final regulations describe when a payment in the nature of compensation is considered made for purposes of section 4960(a)(2), based on the rules in §1.280G-1, Q/A-11 through Q/A-14. Consistent with the rules provided under §1.280G-1, Q/A-12(a), these final regulations provide that the transfer of section 83 property generally is considered a payment made in the taxable year in which the fair market value of the property would be includible in the gross income of the covered employee under section 83, disregarding any election made by the employee under section 83(b) or (i). In addition, similar to the rules provided under §1.280G-1, Q/A-13(a), these regulations generally provide that stock options are treated as property

transferred on the date of vesting (regardless of whether the option has a "readily ascertainable value" as defined in §1.83-7(b)). For purposes of determining the timing and amount of any payment related to an option, the principles of §1.280G-1, Q/A-13 and Rev. Proc. 2003-68 (2003-2 C.B. 398) apply.

E. Computation of Excess Parachute Payments

Consistent with section 4960(c)(5)(A), these final regulations provide that an "excess parachute payment" is an amount equal to the excess of any parachute payment over the portion of the base amount allocated to the payment. The portion of the base amount allocated to any parachute payment is the amount that bears the same ratio to the base amount as the present value of the parachute payment bears to the aggregate present value of all parachute payments to be made to the covered employee. The rules on allocation of the base amount in these regulations are based on §1.280G-1, Q/A-38.

VI. Calculation, Reporting, and Payment of the Tax

ATEOs (and any related non-ATEO organizations) are liable for the excise tax imposed by section 4960 only if they pay a covered employee sufficient remuneration to trigger the tax. An ATEO is not subject to the excise tax under section 4960(a)(1) unless the ATEO (together with any related organizations) pays more than \$1 million of remuneration to a covered employee for a taxable year. An ATEO cannot make an excess parachute payment subject to the excise tax under section 4960(a)(2) if the employer does not have any HCEs under section 414(q)¹⁰ for the taxable year. If both of these situations apply to an ATEO, the ATEO is not liable for any excise tax under section 4960 for that taxable year.

These final regulations generally adopt the proposed rules regarding the entity that is liable for the excise tax under section 4960 and how that excise tax is calculated. These regulations provide that

¹⁰ See footnote 9.

the employer, as determined under section 3401(d), without regard to paragraph (d) (1) or (d)(2), is liable for the excise tax imposed under section 4960. Further, as authorized by section 4960(d), a payment by the employer may be treated as remuneration or a parachute payment if, based on the facts and circumstances, the payment is structured such that it has the effect of avoiding the tax applicable under section 4960. For example, the excise tax under section 4960 would apply with respect to an individual who is an employee of an ATEO or related organization but who is incorrectly classified as an independent contractor. Similarly, the excise tax under section 4960 would apply to an amount paid to a limited liability company or other entity owned all or in part by an employee (or owned by another entity unrelated to the ATEO or related organization) for services performed by an employee of the ATEO or related organization if the arrangement would otherwise have the effect of avoiding the tax applicable under section 4960. For a further discussion of the definition of “employer” see section II.D. of this Summary of Comments and Explanation of Revisions, titled “Employer.”

A. Calculation of Tax on Excess Remuneration

An individual may perform services as an employee of an ATEO and as an employee of one or more related organizations during the same applicable year, in which case remuneration paid for the taxable year is aggregated for purposes of determining whether excess remuneration has been paid. To address these cases, these final regulations adopt the proposed rules for allocating liability for the excise tax among the related employers. As provided in section 4960(c)(4)(C), in any case in which an ATEO includes remuneration from one or more related organizations as separate employers of the individual in determining the excise tax imposed by section 4960(a), each employer is liable for its proportionate share of the excise tax. In contrast, a payment to an individual for performing services as an employee of an ATEO that is made by a third-party payor (whether the payor is related to the ATEO or not) is remuneration paid by the

ATEO for section 4960 purposes and thus is included with any remuneration paid directly by the ATEO (and the related liability is not allocated to the other organization). If a covered employee is employed by one employer when the legally binding right to the remuneration is granted and by a different employer at vesting, then the covered employee’s employer at vesting is treated as paying the remuneration, provided the employment relationship is bona fide and not a means to avoid tax under section 4960. A related organization may become (or cease to be) related during the applicable year, in which case only remuneration the related organization pays (or is treated as paying due to vesting) to the ATEO’s covered employee during the portion of the applicable year that it is a related organization is treated as paid by the ATEO for the taxable year, as provided in section 4960(c)(4)(A).

If an employee is a covered employee of more than one ATEO, these final regulations provide that each ATEO calculates its liability under section 4960(a)(1), taking into account remuneration paid to the employee by the organizations to which it is related. These regulations also provide that, rather than owing tax as both an ATEO and a related organization for the same remuneration paid to a covered employee, each employer is liable only for the greater of the excise tax for which it would be liable as an ATEO or the excise tax it would be liable for as a related organization with respect to that covered employee (and if there is more than one related group of organizations, then for the group that results in the greatest amount of tax). These regulations provide that these same allocation principles apply in the case of the allocation of liability in situations involving an ATEO or related organization with a short taxable year, and should be applied in a manner that avoids, to the extent possible, duplicative taxation of remuneration paid to the same individual. Because the application of the allocation rules may prove complicated in situations involving short taxable years, especially if those situations also involve multiple short taxable years or differing taxable years among the group constituting the ATEO and its related organizations, the regulations further provide that the Commissioner may prescribe guid-

ance of general applicability addressing how the allocation rules apply in particular circumstances involving short taxable years.

Under section 4960(b) and (c)(4)(C), the employer or employers are liable for the excise tax imposed by section 4960. Related organizations must obtain information from each other on remuneration paid to covered employees in order to calculate the tax and their share of the liability. One commenter noted that there may be situations in which an employer is unable to obtain complete information on the remuneration and benefits paid by other employers. The commenter requested guidance on relief from penalties or interest for an error if the employer made a bona fide attempt to obtain the necessary information when it became aware of the error and requested guidance on what would be a bona fide attempt for this purpose. If an ATEO or related organization fails to pay tax it is liable for due to failure to obtain information on remuneration paid by other organizations within the related group, it may be liable for a civil penalty under section 6651 (and in some cases, criminal penalties). Section 6651 includes an exception for reasonable cause. Guidance as to reasonable cause for penalty relief, and therefore the guidance requested by this commenter, is beyond the scope of these final regulations, and therefore is not addressed in these final regulations.

B. Calculation of Tax on an Excess Parachute Payment

These final regulations adopt the proposed regulations with respect to the rules for the calculation of tax on an excess parachute payment. With respect to the calculation of, and liability for, the tax on excess parachute payments, the proposed regulations differed in one respect from the guidance provided in Q/A–1 of Notice 2019-09. Notice 2019-09 provided that an ATEO or related organization may be liable for the tax on an excess parachute payment based on the aggregate parachute payments made by the ATEO and its related organizations, including parachute payments based on separation from employment from a related organization. As in the proposed regulations, these final regulations provide that only an excess para-

chute payment paid by an ATEO is subject to the excise tax on excess parachute payments. However, consistent with the provision in section 4960(c)(5)(D) that rules similar to section 280G(b)(3) apply for purposes of determining the base amount under section 4960, payments from all related organizations (including payments from non-ATEOs) are considered for purposes of determining the base amount and total payments in the nature of compensation that are contingent on the covered employee's separation from employment with the employer. See §1.280G-1, Q/A-34. Generally, this means that a covered employee's base amount calculation includes remuneration from the ATEO and all related organizations, and that a covered employee's parachute payment calculation includes all payments (made by the ATEO and all related organizations) that are contingent on the employee's involuntary separation from employment. However, only an ATEO is subject to the excise tax on excess parachute payments it makes to a covered employee. A non-ATEO that pays an amount that would otherwise be an excess parachute payment is not subject to the excise tax. These regulations further provide that, based on the facts and circumstances, the Commissioner may reallocate excess parachute payments to an ATEO if it is determined that excess parachute payments were made by a non-ATEO for the purpose of avoiding the tax under section 4960. Step by step instructions for calculating the tax on excess parachute payments were provided in section VI.B. of the Explanation of Provisions of the proposed regulations, titled "Calculation of Tax on an Excess Parachute Payment."

C. Reporting and Payment of the Tax

These final regulations adopt without change the rules provided in the proposed regulations relating to the reporting and payment of the excise tax. Under §§53.6011-1 and 53.6071-1, the excise tax under section 4960 is reported on Form 4720, "Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal

Revenue Code," which is the form generally used for reporting and paying chapter 42 taxes. The reporting and payment of any applicable taxes are due when payments of chapter 42 taxes are ordinarily due (the 15th day of the 5th month after the end of the taxpayer's taxable year—May 15 for a calendar year employer), subject to an extension of time for filing returns and making payments¹¹ that generally applies. Because section 6655 has not been amended to include section 4960, no quarterly payments of estimated excise tax imposed by section 4960 are required under section 6655.

These final regulations require that the excise tax imposed by section 4960 be reported and paid in the form and manner prescribed by the Commissioner, and §53.6011-1 requires that every person (including a governmental entity) liable for the excise tax imposed by section 4960 shall file Form 4720, "Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code." Notice 2019-09, Q/A-33(a) required each employer liable for the excise tax imposed by section 4960 to file a separate Form 4720 to report its share of liability. Two commenters recommended allowing related employers to file a joint Form 4720, as has been permitted in §53.6011-1(c) for private foundations and their disqualified persons and foundation managers. In addition to being beyond the scope of these regulations, permitting joint filing of Form 4720 is incompatible with electronic filing of Form 4720 that is required for certain tax-exempt organizations under the Taxpayer First Act, Pub. L. 116-25. See Notice 2021-01.

These final regulations also provide that an employer may elect to prepay the excise tax imposed under section 4960(a)(2) for excess parachute payments in the year of separation from employment or any taxable year prior to the year in which the parachute payment is actually paid. This prepayment rule for the tax applicable to excess parachute payments is similar to the rule in §1.280G-1, Q/A-11(c), under which a disqualified employee may elect to prepay the excise tax under section 4999 based on the present value of the

excise tax that would be owed by the employee when the parachute payments are actually made.

VII. Applicability Date

These final regulations were proposed to apply to taxable years beginning after December 31 of the calendar year in which the Treasury decision adopting these rules as final regulations is published in the Federal Register. The Treasury Department and the IRS requested comments on the burdens anticipated and the timeframe expected to be necessary to implement these final regulations (taking into account that the statutory provisions are already effective).

One commenter recommended that these final regulations apply to taxable years beginning after December 31 of the calendar year that ends at least six months after the date on which these final regulations are published in the Federal Register in order for ATEOs and related organization to have sufficient time to understand and apply these final regulations. The Treasury Department and the IRS agree with this recommendation, and therefore these final regulations apply to taxable years beginning after December 31, 2021 (with the first applicable year generally being the 2022 calendar year).

The guidance provided in these final regulations and the proposed regulations generally is consistent with the guidance provided in Notice 2019-09. Until the applicability date of these final regulations, taxpayers may rely on the guidance provided in Notice 2019-09 in its entirety or on the proposed regulations in their entirety. Alternatively, taxpayers may choose to apply these final regulations to taxable years beginning after December 31, 2017, and on or before December 31, 2021, provided they apply the final regulations in their entirety and in a consistent manner.

Until the applicability date of these final regulations, taxpayers may also base their positions upon a reasonable, good faith interpretation of the statute that includes consideration of any relevant legislative history. Whether a taxpayer's position that

¹¹ The tentative tax, an estimate, must be paid by the due date of Form 4720 without extensions and may be paid with Form 8868, "Application for Automatic Extension of Time To File an Exempt Organization Return."

is inconsistent with Notice 2019-09, the proposed regulations, or these final regulations constitutes a reasonable, good faith interpretation of the statute generally will be determined based upon all of the relevant facts and circumstances, including whether the taxpayer has applied the position consistently and the extent to which the taxpayer has resolved interpretive issues based on consistent principles and in a consistent manner. Notwithstanding the previous sentence, the preamble to Notice 2019-09 describes certain positions that the Treasury Department and the IRS have concluded are not consistent with a reasonable, good faith interpretation of the statutory language, and the proposed regulations and these final regulations reflect this view. For a description of each of these positions, see section VII of the Explanation of Provisions of the proposed regulations, titled “Proposed Applicability Date.”

Special Analyses

I. Regulatory Planning and Review

Executive Orders 13771, 13563, and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. The Executive Order 13771 designation for this rule is “regulatory.”

The regulations have been designated as subject to review under Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget (OMB) regarding review of tax regulations. The Office of Information and Regulatory Affairs (OIRA) has designated the rulemaking as significant under section 1(c) of the Memorandum of Agreement. Accordingly, OMB has reviewed the regulations.

A. Background

1. The Excise Tax Under Section 4960

Section 4960 was added to the Code by TCJA. Section 4960(a) subjects excess remuneration above \$1 million and excess parachute payments that an ATEO pays to a covered employee to an excise tax equal to the rate of tax imposed on corporations under section 11 (21 percent for 2020). Before TCJA, compensation paid by tax-exempt organizations was not subject to an excise tax, although section 4958 applies an excise tax to penalize excess benefit transactions in which an “applicable tax-exempt organization” (as defined in section 4958) provides a benefit to a disqualified person that exceeds the reasonable fair market value of the services received.

Section 4960 defines an “ATEO” as any organization which is exempt from taxation under section 501(a), is a farmers’ cooperative organization described in section 521(b)(1), has income excluded from taxation under section 115(1), or is a political organization described in section 527(e)(1). Covered employees of an ATEO include the five highest-compensated employees of the organization for the taxable year and any employee or former employee who was a covered employee of the organization (or predecessor) for any preceding taxable year beginning after December 31, 2016.

“Remuneration” means “wages” as defined in section 3401(a) (excluding designated Roth contributions) and includes amounts required to be included in gross income under section 457(f). Section 4960 excludes from remuneration any amount paid to a licensed medical professional for medical or veterinary services provided. Remuneration also includes payments with respect to employment of a covered employee by any person or government entity related to the ATEO. A person or governmental entity is treated as related to the ATEO if that person or governmental entity controls, or is controlled by, the ATEO, is controlled by one or more persons which control the ATEO, is a “supported organization” (as defined in section 509(f)(3)) during the taxable year with respect to the ATEO, is a supporting

organization described in section 509(a)(3) during the taxable year with respect to the ATEO, or in the case of an organization which is a voluntary employees’ beneficiary association (VEBA) under section 501(c)(9), established, maintains, or makes contribution to such VEBA.

2. Notice 2019-09 and the Proposed and Final Regulations

Notice 2019-09 provided taxpayers with initial guidance on the application of section 4960, including that taxpayers may base their positions on a reasonable, good faith interpretation of the statute until further guidance is issued. On June 11, 2020, the Treasury Department and the IRS published proposed regulations on section 4960 in the **Federal Register** (REG-122345-18, 85 FR 35746) (the proposed regulations). The Treasury Department and the IRS received comments responding to the proposed regulations, which were considered in these final regulations, published here. The comments primarily discussed the treatment of employees of a related organization who also provide services to the ATEO, suggesting various exceptions for these situations. Comments also addressed the possibility of a grandfather rule for compensation to be paid under arrangements in place prior to the effective date of section 4960, treatment of deferred compensation as remuneration, the definition of “control,” and which organizations are ATEOs.

B. Baseline

The Treasury Department and the IRS have assessed the benefits and costs of the final regulations relative to a no-action baseline reflecting anticipated Federal income tax-related behavior in the absence of these regulations.

C. Affected Entities

The final regulations affect an estimated 261,000 ATEOs and 77,000 non-ATEO related organizations of ATEOs that in historical filings report substantial executive compensation.¹² Of the roughly 261,000

¹²The methods and data used to estimate the number of affected entities are discussed in detail in the Paperwork Reduction Act special analysis.

such ATEOs based on filings for tax year 2017, 239,000 are section 501(a) exempt organizations (including 23,000 private foundations), 19,000 are section 115 state and local instrumentalities, 2,000 are section 527 political organizations, 600 are exempt farmers' cooperative organizations described in section 521(b)(1), and 200 are federal instrumentalities (although the Treasury Department and the IRS will continue to consider whether federal instrumentalities are ATEOs).

D. Economic Analysis

This section describes the key economic effects of the provisions of these final regulations.

1. Clarifications

Most provisions of these final regulations clarify aspects of the excise tax imposed by section 4960, minimizing the burdens entities bear to comply with section 4960, and have little other economic impact. Clarifications reduce uncertainty, lowering the effort required to infer which organizations, employees, and payments are subject to the excise tax and the potential for conflict if entities and tax administrators interpret provisions differently. Examples of provisions of these final regulations that are primarily clarifications include the definition of "control," treatment of deferred compensation and vesting, and which organizations are ATEOs.

2. "Volunteer" Exceptions

Several commenters expressed concern that highly-paid employees of a non-ATEO performing services for a related ATEO without receiving compensation from the ATEO may be subject to the excise tax. To avoid the excise tax, individuals might cease performing such services, or ATEOs might dissolve their relationships with related non-ATEOs, reducing donations from related non-ATEOs.

The final regulations include exceptions to the definitions of "employee" and "covered employees" (specifically to the rules for determining the five highest compensated employees for purposes of identifying covered employees) to address such situations. With respect to the first

exception, the regulations define "employee" consistent with section 3401(c), in particular adopting the rule that a director is not an employee in the capacity as a director and an officer performing minor or no services and not receiving any remuneration for those services is not an employee.

The general rule provides that employees of a related non-ATEO are not considered for purposes of determining the five highest-compensated employees if they are never employees of the ATEO. In addition, individuals who receive no remuneration (or grant of a legally binding right to remuneration) from the ATEO or a related organization cannot be among the ATEO's five highest-compensated employees.

Under the exceptions, an ATEO's five highest-compensated employees also exclude an employee of the ATEO who receives no remuneration from the ATEO and performs only limited hours of service for the ATEO, which means that no more than 10 percent of total annual hours worked for the ATEO and related organizations are for services performed for the ATEO. An employee who performs fewer than 100 hours of services as an employee of an ATEO and its related ATEOs is treated as having worked less than 10 percent of total hours for the ATEO and related ATEOs. An employee who is not compensated by an ATEO, related ATEO, or any taxable related organization controlled by the ATEO and who primarily (more than 50 percent of total hours worked) provides services to a related non-ATEO is also disregarded. In response to comments on the proposed regulations expressing concern that this exception did not provide sufficient flexibility for situations in which an employee of a non-ATEO performs services for a related ATEO as a temporary assignment, these final regulations provide that the 50 percent of total hours worked threshold can be computed over a period of two consecutive years, rather than a single year. This modification expands the exception to provide additional flexibility. An employee is also disregarded if an ATEO paid less than 10 percent of the employee's total remuneration for services performed for the ATEO and all related organizations, and the ATEO had at least one related ATEO during the applicable year. Additionally, if neither the

ATEO nor any related ATEO paid more than 10 percent of the employee's total remuneration, then the ATEO that paid the highest percent of remuneration does not meet this exception.

Consider, for example, a corporate employee making \$2 million per year who spends 5 percent of her time (roughly one day each month) working for the corporation's foundation, a related ATEO, without receiving compensation from the ATEO and who would be a covered employee of the ATEO absent the exceptions. Without the exceptions, her compensation in excess of \$1 million from the corporation, which is a related party of the foundation, is subject to a 21 percent excise tax, or \$210,000 in excise tax liability. The exceptions (either of the first two could apply here) remove that liability and the incentive it provides to stop providing such services or to dissolve the relationship between the ATEO and the related organization. The exceptions support a transfer of substantial value (5 percent of the employee's salary, or \$100,000) that might otherwise not take place.

Commenters on the proposed regulations suggested other ways in which the exceptions could be expanded. The Treasury Department and the IRS considered these suggested expansions of the exceptions and concluded that the suggestions were inconsistent with the statute and legislative history or would enable organizations to circumvent the excise tax in situations where an individual performs services for an ATEO on more than a volunteer basis, creating the potential for abuse and increasing the costs of administering the excise tax. Therefore, these final regulations do not adopt the suggested expansions of the exceptions.

The exceptions in these final regulations may have a substantial impact on donations relative to a no-action baseline, although the magnitude of the potential impact depends on how often the exceptions apply and on how responsive organizations and employees are to the excise tax, both of which are uncertain.

The exceptions apply only in particular circumstances: for example, the employee must be employed by a related organization (typically an organization that controls or is controlled by the ATEO), the employee must be highly compensated,

and the employee's work for the ATEO must be sufficiently minimal. Historically, many ATEOs report employees with compensation from related organizations. An estimated 8,500 ATEOs filing Form 990 in tax year 2017 reported both compensation of \$500,000 or more for any person and any compensation from related organizations. These ATEOs are estimated to have an average of 18 non-ATEO related organizations based on information reported on Form 990 Schedule R, yielding an estimated 154,000 non-ATEO related organizations, of which half, or 77,000, are estimated to employ a covered employee of the ATEO. The fraction of the 154,000 non-ATEO related organizations with employees to whom the exceptions apply (and who are thus not covered employees of the ATEO) is uncertain, but perhaps half the related organizations, or 77,000, have such an employee.

This entity count omits a substantial number of private foundations which may have employees who receive no compensation from the ATEO but who are highly compensated by related organizations, because while the ATEO count used in these estimates includes approximately 100 private foundations that have historically reported employee compensation of \$500,000 or more on Form 990-PF, Form 990-PF (unlike Form 990) does not include information on employee compensation received from related organizations. The exceptions are particularly likely to apply to donations to foundations related to non-ATEO businesses, as companies are highly likely to be related organizations of a company's foundation, many family foundations are controlled by the same family that controls a private business, and executives of the related business often provide services to the foundation without payment from the foundation. Because of these facts, looking at pre-TCJA tax forms may underestimate the number of entities potentially affected by the exceptions. In the U.S. in 2015, there were about 2,000 company foundations responsible for \$5.5 billion in giving, and 42,000 family foundations.¹³ It is reasonable to assume that about half of these foundations, or 22,000, have a related business with an employee to whom the exceptions apply.

Under reasonable assumptions about the response of donated services to the excise tax, the exceptions may restore substantial donations (transfers) of services that the excise tax could potentially otherwise eliminate. Totalling both private foundations and other ATEOs, roughly 99,000 related organizations are estimated to have employees to whom the exceptions apply. If the excise tax would have reduced services that are donated under the exceptions by an average of just over \$5,000 per related organization, the total transfer reduction exceeds \$500 million.

Absent the exceptions, organizations may also avoid the excise tax by dissolving the relationship between the ATEO and non-ATEO, which may affect donations of money as well as services. Considering only corporate foundations and setting aside other ATEOs, if such dissolutions would lead to a two percent reduction in the \$5.5 billion in corporate giving that would otherwise take place through related foundations, the reduction exceeds \$100 million. The Treasury Department and the IRS requested but did not receive comments on the impact of the exceptions on the dissolution of relationships between ATEOs and related organizations.

It is plausible that these final regulations restore substantial economic activity relative to regulatory alternatives, under which the excise tax would discourage highly-compensated employees of related non-ATEOs from providing services to a related ATEO without compensation from the ATEO and discourage relationships between ATEOs and non-ATEOs.

3. Summary

This analysis suggests that these final regulations will reduce compliance burden on affected entities by providing clarifications and, through the exceptions, increase services provided to ATEOs without compensation from the ATEO by a small but potentially economically significant amount (\$100 million or more), relative to regulatory alternatives. The Treasury Department and the IRS requested but did not receive comments on the economic impact of these proposed regulations (in particular, comments providing

data, other evidence, or models that provide insight).

II. Paperwork Reduction Act

The collections of information in these final regulations are in §53.4960-1(d), (h), and (i); §53.4960-2(a), (c) and (d); and §53.4960-4(a) and (d). This information is required to determine an ATEO's "covered employees" as defined in section 4960(c)(2); to calculate remuneration in excess of \$1 million as described in section 4960(c)(3); to determine remuneration from related organizations and allocation of liability as described in section 4960(c)(4); and to determine any excess parachute payments to covered employees described in section 4960(c)(5).

The IRS intends that the burden of the collections of information will be reflected in the burden associated with Form 4720, under OMB approval number 1545-0047. The burden associated with Form 4720 is included in the aggregated burden estimates for OMB control number 1545-0047, which represents a total estimated burden time for all forms and schedules of 52.450 million hours and total estimated burden in dollars of \$1.497 billion (estimated for fiscal year 2021). The overall burden estimates provided for 1545-0047 are aggregate amounts that relate to all information collections associated with that OMB control number. This estimate is therefore unrelated to the future calculations needed to assess the burden imposed by these regulations. To guard against over-counting the burden imposed, the Treasury Department and the IRS urge readers to recognize that these burden estimates are aggregates for the applicable types of filers. For purposes of the Paperwork Reduction Act, the Treasury Department and the IRS have not estimated the burden, including that of any new information collections, related to the requirements under these final regulations. Future burden estimates under OMB control number 1545-0047 would capture changes made by TCJA and changes that arise out of discretionary authority exercised in the regulations.

The expected burden associated with section 4960 compliance (including Form

¹³ <http://data.foundationcenter.org/>

4720 preparation and filing) for ATEOs as described in section 4960(c)(1) and related organizations as described in section 4960(c)(4)(B) is listed below:

Estimated number of respondents: 337,888

Estimated average annual burden hours per response: 0.20 hours

Estimated total annual burden: \$3,569,632 (2020)

Estimated frequency of collection: Annual

In the proposed regulations, the Treasury Department and the IRS requested comments on all aspects of information collection burdens related to the proposed regulations, including estimates for how much time it would take to comply with the paperwork burdens previously described in this section for each relevant form and ways for the IRS to minimize the paperwork burden. The Treasury Department and the IRS did not receive any comments on these issues. Revisions (if any) to these forms that reflect the information

collections included in these final regulations will be made available for public comment at <https://apps.irs.gov/app/picklist/list/draftTaxForms.html> and will not be finalized until after these forms have been approved by OMB under the PRA. Comments on these forms can be submitted at <https://www.irs.gov/forms-pubs/comment-on-tax-forms-and-publications>.

The current status of the PRA submissions related to section 4960 are provided in the following table.

Form	Type of Filer	OMB Number(s)	Status
Form 4720	Tax-exempt organizations and their related organizations, including for-profit and government entities	1545-0047	Published in the Federal Register on 11/12/20. Public comment period closes on 1/11/21.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law.

Generally, tax returns and return information are confidential, as required by 26 U.S.C. 6103.

III. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (RFA) (5 U.S.C. chapter 6), it is hereby certified that these final regulations will not have a significant economic impact on a substantial number of small entities. In the proposed regulations, the Treasury Department and the IRS invited comments on the impact this rule would have on small entities. The Treasury Department and the IRS did not receive any comments on this issue.

The Regulatory Flexibility Act (5 U.S.C. 601 et seq.) (RFA) generally defines a “small entity” as (1) a proprietary firm meeting the size standards of the

Small Business Administration (SBA) (13 CFR 121.201), (2) a nonprofit organization that is not dominant in its field, or (3) a small government jurisdiction with a population of less than 50,000. (States and individuals are not included in the definition of “small entity.”) The Treasury Department and the IRS estimate that these final regulations will affect 324,000 small entities, 73,000 of which are proprietary firms meeting the size standards of the SBA and 251,000 of which are nonprofit organizations that are not dominant in their fields or small government jurisdictions with a population of less than 50,000.

The Treasury Department and the IRS estimated the number of ATEOs, based primarily on Form 990 data for filers with at least one employee (and thus having a burden, at a minimum, of maintaining annual lists of covered employees), as 261,118, and the number of non-ATEO related organizations employing at least one covered employee of an ATEO as 76,770, for a total of 337,888 affected entities. The SBA defines a small business as an independent business having fewer than 500 employees. (See A Guide for Government Agencies, How to Comply with the Regulatory Flexibility Act, Appendix B¹⁴). Tax data available to the Treasury Department

and the IRS include employee counts for only half the affected entities, as employee counts are included on Form 990, but not on other forms including Form 990-EZ and 990-PF. An examination of tax data from 2016 shows that for filers for whom employee counts were available and who had at least one employee, 96.5 percent had fewer than 500 employees. Similarly, there are no bright lines in the available data to distinguish small nonprofit organizations that are not dominant in their field. An examination of non-tax data shows that a similar proportion, approximately 96 percent, of all incorporated cities, towns, and villages in 2014 had a population of less than 50,000, which may serve as a proxy for small government jurisdictions generally.¹⁵ By applying the 96 percent estimate to all entities affected by section 4960, the Treasury Department and the IRS estimate that 324,000 small entities are affected by these regulations. However, the Treasury Department and the IRS have determined that the rules regarding an ATEO’s covered employees will not have a significant economic impact on affected small entities as described later in this discussion of the RFA.

Section 4960 imposes the excise tax on ATEOs and their related organizations

¹⁴ <https://advocacy.sba.gov/2017/08/31/a-guide-for-government-agencies-how-to-comply-with-the-regulatory-flexibility-act/>
¹⁵ See <https://www.statista.com/statistics/241695/number-of-us-cities-towns-villages-by-population-size/>

to the extent they pay certain compensation to a covered employee. Because covered employee status is permanent, every ATEO must determine its five highest-compensated employees for the taxable year—even if the ATEO is not subject to the tax for that taxable year—and maintain a list of covered employees. Accordingly, these final rules likely will affect a substantial number of small entities, especially nonprofit entities that are not dominant in their fields.

The Treasury Department and the IRS estimate that the vast majority of ATEOs, particularly small ATEOs, can determine their five highest-compensated employees for the taxable year under the method provided in these final rules very quickly and at negligible cost using information already collected in the normal course of business. The time necessary to determine an ATEO's five highest-compensated employees is positively correlated with the size of the entity (that is, the smaller the entity, the less time such a determination should take). Larger ATEOs may need more time, but it is estimated that this determination will take less than seven hours. The burden for making this determination is estimated to fall on the small number of larger ATEOs. Putting these two groups together, the total estimated cost for all 261,118 ATEOs to make these determinations is \$1,255,760 per year, averaging \$4.81 per ATEO. Thus, it is hereby certified that these final regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) (RFA).

Pursuant to section 7805(f) of the Code, the proposed regulations preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small entities and no comments were received.

IV. *Unfunded Mandates Reform Act*

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any

one year by a state, local, or tribal government, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation. This final rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

V. *Executive Order 13132: Federalism*

Executive Order 13132 (titled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on state and local governments, and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This final rule does not have federalism implications that are not required by the statute and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

VI. *Congressional Review Act*

The Administrator of OIRA has determined that this is a major rule for purposes of the Congressional Review Act (5 U.S.C. 801 *et seq.*) (CRA). Under section 801(3) of the CRA, a major rule takes effect 60 days after the rule is published in the Federal Register.

Notwithstanding this requirement, section 808(2) of the CRA allows agencies to dispense with the requirements of section 801 when the agency for good cause finds that such procedure would be impracticable, unnecessary, or contrary to the public interest and the rule shall take effect at such time as the agency promulgating the rule determines. Pursuant to section 808(2) of the CRA, the Treasury Department and the IRS find, for good cause, that a 60-day delay in the effective date is unnecessary and contrary to the public interest.

Following the addition of section 4960 to the Code by TCJA, the Treasury Department and the IRS published the proposed regulations setting forth guidance on all aspects of the law, including certain exceptions to the definition of “employee” and “covered employee” for purposes of

identifying covered employees. The majority of comments received in response to the proposed regulations requested additional clarifications or modifications of the rules for these exceptions. In response, these final regulations include certain clarifications and modifications to the proposed rules. The clarifications and modifications in these final regulations reduce both uncertainty and the burden associated with application of these rules.

In response to certain commenter requests that the applicability date of the final regulations be delayed after publication of the regulations as final in the Federal Register so that ATEOs and related organizations have sufficient time to understand and apply these final regulations, these final regulations apply to taxable years beginning after December 31, 2021. However, until the applicability date, taxpayers may choose to apply these final regulations to taxable years beginning after December 31, 2017, and on or before December 31, 2021, provided the taxpayer applies them in their entirety and in a consistent manner. Therefore, ATEOs and related organizations that wish to apply these regulations prior to the applicability date will need to know that these final regulations are effective before incurring necessary costs to timely comply with these final regulations. In particular, certainty that these rules are effective is essential to taxpayers so that they can determine whether and to what extent the excise tax imposed by section 4960 applies to an organization and which employees are covered employees, given that taxpayers will begin preparing their 2020 tax returns in early 2021. Further, for these potentially affected taxpayers, certainty with respect to these rules is necessary for them to proceed with several aspects of their operations, including employee hiring and retention, designing of compensatory arrangements, recordkeeping, and maintaining relationships between related non-ATEOs and ATEOs—including with respect to donating of services. Further, the COVID-19 pandemic has affected many ATEOs, and providing additional clarification regarding these rules, in particular with respect to the exceptions for purposes of determining covered employees, will better enable ATEOs and

related organizations to perform financial and operational planning tasks for the tax year as they anticipate the easing of restrictions that have severely impacted their operations during the COVID-19 pandemic. Consistent with Executive Order 13924 (May 19, 2020), the Treasury Department and the IRS have therefore determined that an expedited effective date of these final regulations will provide critical guidance on what the law requires for taxpayers to determine whether the excise tax imposed by section 4960 applies, which employees may be considered to be covered employees, and what actions are required under the law as a result. Accordingly, the Treasury Department and the IRS have determined that the rules in this Treasury decision will take effect on the date of filing for public inspection in the Federal Register.

Statutory Authority

The regulations are adopted pursuant to the authority contained in sections 7805 and 4960.

Drafting Information

The principal authors of the regulations are William McNally and Patrick Sternal of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). However, other personnel from the Treasury Department and the IRS participated in the development of the regulations.

Statement of Availability

IRS Revenue Procedures, Revenue Rulings, Notices, and other guidance cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at <https://www.irs.gov>.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and record-keeping requirements

26 CFR Part 53

Excise taxes, Foundations, Investments, Lobbying, Reporting and record-keeping requirements

Amendments to the Regulations

Accordingly, the Department of the Treasury and the Internal Revenue Service amend 26 CFR parts 1 and 53 as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 ***

Par. 2. Section 1.338-1 is amended by revising paragraph (b)(2)(i) to read as follows:

§1.338-1 General principles; status of old target and new target.

* * * * *

(b) * * *

(2) * * *

(i) The rules applicable to employee benefit plans (including those plans described in sections 79, 104, 105, 106, 125, 127, 129, 132, 137, and 220), qualified pension, profit-sharing, stock bonus and annuity plans (sections 401(a) and 403(a)), simplified employee pensions (section 408(k)), tax qualified stock option plans (sections 422 and 423), welfare benefit funds (sections 419, 419A, 512(a) (3), and 4976), voluntary employees' beneficiary associations (section 501(c) (9) and the regulations thereunder), and tax on excess tax-exempt organization executive compensation (section 4960) and the regulations in part 53 under section 4960;

PART 53—FOUNDATION AND SIMILAR EXCISE TAXES

Par. 3. The authority citation for part 53 is revised to read in part as follows:

Authority: 26 U.S.C. 7805; 4960.

Par. 4. Sections 53.4960-0 through 53.4960-6 are added to read as follows:

53.4960-0 Table of contents.

53.4960-1 Scope and definitions.

53.4960-2 Determination of remuneration paid for a taxable year.

53.4960-3 Determination of whether there is a parachute payment.

53.4960-4 Liability for tax on excess remuneration and excess parachute payments.

53.4960-5 Coordination with section 162(m) [reserved].

53.4960-6 Applicability date.

§53.4960-0 Table of contents.

§53.4960-1 Scope and definitions

(a) Scope.

(b) Applicable tax-exempt organization.

(1) In general.

(i) Section 501(a) organization.

(ii) Section 521 farmers' cooperative.

(iii) Section 115(1) organization.

(iv) Section 527 political organization.

(2) Certain foreign organizations.

(3) [Reserved].

(c) Applicable year.

(1) In general.

(2) Examples.

(3) Short applicable years.

(i) In general

(ii) Initial year of ATEO status.

(iii) Year of termination of ATEO status.

(A) Termination on or before the close of the calendar year ending with or within the taxable year of termination.

(B) Termination after the close of the calendar year ending in the taxable year of termination.

(4) Examples.

(d) Covered employee.

(1) In general.

(2) Five highest-compensated employees.

(i) In general.

(ii) Limited hours exception.

(A) In general.

(I) Remuneration requirement.

(2) Hours of service requirement.

(B) Certain payments disregarded.

(C) Safe harbor.

(iii) Nonexempt funds exception.

(A) In general.

- (1) Remuneration requirement.
- (2) Hours of service requirement.
- (3) Related organizations requirement.
- (B) Certain payments disregarded.
- (iv) Limited services exception.
- (A) Remuneration requirement.
- (B) Related ATEO requirement.
- (1) Ten percent remuneration condition.
- (2) Less remuneration condition.
- (3) Examples.
- (e) Employee.
- (1) In general.
- (2) Directors.
- (3) Trustees.
- (f) Employer.
- (1) In general.
- (2) Disregarded entities.
- (g) Medical services.
- (1) Medical and veterinary services.
- (i) In general.
- (ii) Examples.
- (2) Definition of licensed medical professional.
- (h) Predecessor.
- (1) Asset acquisitions.
- (2) Corporate reorganizations.
- (3) Predecessor change of form or of place of organization.
- (4) ATEO that becomes a non-ATEO.
- (i) General rule.
- (ii) Intervening changes or entities.
- (5) Predecessor of a predecessor.
- (6) Elections under sections 336(e) and 338.
- (7) Date of transaction.
- (i) Related organization.
- (1) In general.
- (i) Controls or controlled by test.
- (ii) Controlled by same persons test.
- (iii) Supported organization test.
- (iv) Supporting organization test.
- (v) VEBA test.
- (2) Control.
- (i) In general.
- (ii) Stock corporation.
- (iii) Partnership.
- (iv) Trust.
- (v) Nonstock organization.
- (A) In general.
- (B) Control of a trustee or director of a nonstock organization.
- (C) Representatives.
- (vi) Brother-sister related organizations.
- (vii) Section 318 principles.
- (A) In general.

- (B) Nonstock organizations.
- (1) Attribution of ownership interest from a nonstock organization to a controlling person.
- (2) Attribution of ownership interest from a controlling person to a nonstock organization.
- (3) Indirect control of a nonstock organization through another nonstock organization.
- (4) Attribution of control of nonstock organization to family member.
- (3) Examples.

§53.4960-2 Determination of remuneration paid for a taxable year

- (a) Remuneration.
- (1) In general
- (2) Exclusion of remuneration for medical services.
- (i) In general.
- (ii) Allocation of remuneration for medical services and non-medical services.
- (iii) Examples.
- (b) Source of payment.
- (1) Remuneration paid by third parties for employment by an employer.
- (2) Remuneration paid by a related organization for employment by the related organization.
- (c) Applicable year in which remuneration is treated as paid.
- (1) In general.
- (2) Vested remuneration.
- (3) Change in related status during the year.
- (d) Amount of remuneration treated as paid.
- (1) In general.
- (2) Earnings and losses on previously paid remuneration.
- (i) In general.
- (ii) Previously paid remuneration.
- (A) New covered employee.
- (B) Existing covered employee.
- (iii) Earnings.
- (iv) Losses.
- (v) Net earnings.
- (vi) Net losses.
- (3) Remuneration paid for a taxable year before the employee becomes a covered employee.
- (i) In general.
- (ii) Examples.
- (e) Calculation of present value.

- (1) In general.
- (2) Treatment of future payment amount as present value for certain amounts.
- (f) Examples.

§53.4960-3 Determination of whether there is a parachute payment

- (a) Parachute payment.
- (1) In general.
- (2) Exclusions.
- (i) Certain qualified plans.
- (ii) Certain annuity contracts.
- (iii) Compensation for medical services.
- (iv) Payments to non-HCEs.
- (3) Determination of HCEs for purposes of the exclusion from parachute payments.
- (b) Payment in the nature of compensation.
- (1) In general.
- (2) Consideration paid by covered employee.
- (c) When payment is considered to be made.
- (1) In general.
- (2) Transfers of section 83 property.
- (3) Stock options.
- (d) Payment contingent on an employee's separation from employment.
- (1) In general.
- (2) Employment agreements.
- (i) In general.
- (ii) Example.
- (3) Noncompetition agreements.
- (4) Payment of amounts previously included in income or excess remuneration.
- (5) Window programs.
- (6) Anti-abuse provision.
- (e) Involuntary separation from employment.
- (1) In general.
- (2) Separation from employment for good reason.
- (i) In general.
- (ii) Material negative change required.
- (iii) Deemed material negative change.
- (A) Material diminution of compensation.
- (B) Material diminution of responsibility.
- (C) Material diminution of authority of a supervisor.
- (D) Material diminution of a location.
- (E) Material change of location.
- (F) Other material breach.

(3) Separation from employment.
(f) Accelerated payment or accelerated vesting resulting from an involuntary separation from employment.

- (1) In general.
- (2) Nonvested payments subject to a non-service vesting condition.
- (3) Vested payments.
- (4) Nonvested payments subject to a service vesting condition.
 - (i) In general.
 - (A) Vesting trigger.
 - (B) Vesting condition.
 - (C) Services condition.
 - (ii) Value of the lapse of the obligation to continue to perform services.
 - (iii) Accelerated vesting of equity compensation.

- (5) Application to benefits under a non-qualified deferred compensation plan.
- (6) Present value.
- (7) Examples.
- (g) Three-times-base-amount test for parachute payments.
 - (1) In general.
 - (2) Examples.
 - (h) Calculating present value.
 - (1) In general.
 - (2) Deferred payments.
 - (3) Health care.
 - (i) Discount rate.
 - (j) Present value of a payment to be made in the future that is contingent on an uncertain future event or condition.

- (1) Treatment based on the estimated probability of payment.
- (2) Correction of incorrect estimates.
- (3) Initial option value estimate.
- (4) Examples.
- (k) Base amount.
 - (1) In general.
 - (2) Short or incomplete taxable years.
 - (3) Excludable fringe benefits.
 - (4) Section 83(b) income.
 - (1) Base period.
 - (1) In general.
 - (2) Determination of base amount if employee separates from employment in the year hired.
 - (3) Examples.

§53.4960-4 Liability for tax on excess remuneration and excess parachute payments

(a) Liability, reporting, and payment of excise taxes.

- (1) Liability.
- (2) Reporting and payment.
- (3) Arrangements between an ATEO and a related organization.
- (4) Certain foreign related organizations.
- (5) [Reserved].
- (b) Amounts subject to tax.
 - (1) Excess remuneration.
 - (i) In general.
 - (ii) Exclusion for excess parachute payments.
 - (2) Excess parachute payment.
 - (c) Calculation of liability for tax on excess remuneration.
 - (1) In general.
 - (2) Calculation if liability is allocated from more than one ATEO with respect to an individual.
 - (3) Calculation if liability is allocated from an ATEO with a short applicable year.
 - (4) Examples.
 - (d) Calculation of liability for excess parachute payments.
 - (1) In general.
 - (2) Computation of excess parachute payments.
 - (3) Reallocation when the payment is disproportionate to base amount.
 - (4) Election to prepay tax.
 - (5) Liability after a redetermination of total parachute payments.
 - (6) Examples.

§53.4960-5 [Reserved]

§53.4960-6 Applicability date

- (a) General applicability date.
- (b) [Reserved].

§53.4960-1 Scope and definitions.

(a) *Scope.* This section provides definitions for purposes of section 4960, this section, and §§53.4960-2 through 53.4960-6. Section 53.4960-2 provides definitions and rules for determining the amount of remuneration paid for a taxable year. Section 53.4960-3 provides definitions and rules for determining whether a parachute payment is paid. Section 53.4960-4 provides definitions and rules for calculating the amount of excess remuneration paid for a taxable year, excess parachute payments paid in a taxable year, and liability for the

excise tax. Section 53.4960-5 is reserved for rules on the coordination of sections 4960 and 162(m). Section 53.4960-6 provides rules regarding the applicability date for the regulations in §§53.4960-1 through 53.4960-5. The rules and definitions provided in this section through §53.4960-6 apply solely for purposes of section 4960 unless specified otherwise.

(b) *Applicable tax-exempt organization*—(1) *In general.* *Applicable tax-exempt organization* or *ATEO* means any organization that is one of the following types of organizations:

(i) *Section 501(a) organization.* The organization is exempt from taxation under section 501(a) (except as provided in paragraph (b)(2) or (b)(3) of this section);

(ii) *Section 521 farmers' cooperative.* The organization is a farmers' cooperative organization described in section 521(b)(1);

(iii) *Section 115(1) organization.* The organization has income excluded from taxation under section 115(1); or

(iv) *Section 527 political organization.* The organization is a political organization described in section 527(e)(1).

(2) *Certain foreign organizations.* Any foreign organization described in section 4948(b) that either is exempt from tax under section 501(a) or is a taxable private foundation (section 4948(b) organization) is not an ATEO. A foreign organization is an organization not created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States. See section 4948(b) and §53.4948-1. For purposes of this paragraph (b)(2) and the application of section 4960 to a taxable year, an organization's status as a section 4948(b) organization is determined at the end of its taxable year.

(3) [Reserved].

(c) *Applicable year*—(1) *In general.* *Applicable year* means the calendar year ending with or within the ATEO's taxable year. See §53.4960-4 regarding how an ATEO's applicable year affects the liability of related organizations.

(2) *Examples.* The following examples illustrate the rules of paragraph (c)(1) of this section.

(i) *Example 1 (Calendar year taxpayer)*—(A) *Facts.* ATEO 1 uses the calendar year as its taxable year and became an ATEO before 2022.

(B) *Conclusion.* ATEO 1's applicable year for its 2022 taxable year is the period from January 1, 2022, through December 31, 2022 (that is, the 2022 calendar year).

(ii) *Example 2 (Fiscal year taxpayer)*—(A) *Facts.* ATEO 2 uses a taxable year that starts July 1 and ends June 30 and became an ATEO before 2022.

(B) *Conclusion.* ATEO 2's applicable year for the taxable year beginning July 1, 2022, and ending June 30, 2023, is the 2022 calendar year.

(3) *Short applicable years*—(i) *In general.* An ATEO may have an applicable year that does not span the entire calendar year for the initial taxable year that the organization is an ATEO or for the taxable year in which the taxpayer ceases to be an ATEO. The beginning and end dates of the applicable year in the case of an ATEO's change in status depend on when the change in status occurs.

(ii) *Initial year of ATEO status.* For the taxable year in which an ATEO first becomes an ATEO, *applicable year* means the period beginning on the date the ATEO first becomes an ATEO and ending on the last day of the calendar year ending with or within such taxable year (or, if earlier, the date of termination of ATEO status, as described in paragraph (c)(3)(ii)(A) of this section). If the taxable year in which an ATEO first becomes an ATEO ends before the end of the calendar year in which the ATEO first becomes an ATEO, then there is no applicable year for the ATEO's first taxable year; however, for the ATEO's next taxable year, *applicable year* means the period beginning on the date the ATEO first becomes an ATEO and ending on December 31 of the calendar year (or, if earlier, the date of termination of ATEO status, as described in paragraph (c)(3)(ii)(A) of this section).

(iii) *Year of termination of ATEO status*—(A) *Termination on or before the close of the calendar year ending with or within the taxable year of termination.* If an ATEO has a termination of ATEO status during the taxable year and the termination of ATEO status occurs on or before the close of the calendar year ending with or within such taxable year, then, for the taxable year of termination of ATEO status, *applicable year* means the period starting January 1 of the calendar year of the termination of ATEO status and ending on the date of the termination of ATEO status.

(B) *Termination after the close of the calendar year ending in the taxable year of termination.* If an ATEO has a termination of ATEO status during the taxable year and the termination of ATEO status occurs after the close of the calendar year ending within such taxable year, then, for the taxable year of the termination of ATEO status, *applicable year* means both the calendar year ending within such taxable year and the period beginning January 1 of the calendar year of the termination of ATEO status and ending on the date of the termination of ATEO status. Both such applicable years are treated as separate applicable years. See §53.4960-4(b)(2)(ii) for rules regarding calculation of the tax in the event there are multiple applicable years associated with a taxable year.

(4) *Examples.* The following examples illustrate the rules of paragraph (c)(3) of this section. For purposes of these examples, assume any entity referred to

as “ATEO” is an ATEO and any entity referred to as “CORP” is not an ATEO.

(i) *Example 1 (Taxable year of formation ending after December 31)*—(A) *Facts.* ATEO 1, ATEO 2, and CORP 1 are related organizations that all use a taxable year that starts July 1 and ends June 30. ATEO 1 is recognized as a section 501(c)(3) organization by the IRS on May 8, 2023, effective as of October 1, 2022. ATEO 2 became an ATEO in 2017.

(B) *Conclusion (ATEO 1).* ATEO 1's applicable year for the taxable year beginning October 1, 2022, and ending June 30, 2023, is the period beginning October 1, 2022, and ending December 31, 2022. For purposes of determining the amount of remuneration paid by ATEO 1 and all related organizations for ATEO 1's taxable year beginning October 1, 2022, and ending June 30, 2023, (including for purposes of determining ATEO 1's covered employees), only remuneration paid between October 1, 2022, and December 31, 2022, is taken into account. Thus, any remuneration paid by ATEO 1, ATEO 2, and CORP 1 before October 1, 2022, is disregarded for purposes of ATEO 1's applicable year associated with its initial taxable year.

(C) *Conclusion (ATEO 2).* ATEO 2's applicable year for its taxable year beginning July 1, 2022, and ending June 30, 2023, is the 2022 calendar year. Thus, any remuneration paid by ATEO 1, ATEO 2, and CORP 1 during the 2022 calendar year is taken into account for purposes of determining ATEO 2's covered employees and remuneration paid for ATEO 2's taxable year ending June 30, 2023.

(ii) *Example 2 (Taxable year of formation ending before December 31)*—(A) *Facts.* Assume the same facts as in paragraph (c)(4)(i)(A) of this section (Example 1), except that ATEO 1 is recognized as a section 501(c)(3) organization effective as of March 15, 2023.

(B) *Conclusion.* ATEO 1 has no applicable year for the taxable year starting March 15, 2023, and ending June 30, 2023, because no calendar year ends (or termination of ATEO status occurs) with or within the taxable year. ATEO 1's applicable year for the taxable year ending June 30, 2024, is the period beginning March 15, 2023, and ending December 31, 2023. For purposes of determining the amount of remuneration paid by ATEO 1 and all related organizations for ATEO 1's taxable year ending June 30, 2024 (including for purposes of determining ATEO 1's covered employees), only remuneration paid between March 15, 2023, and December 31, 2023, is taken into account. The conclusion for ATEO 2 is the same as in paragraph (c)(4)(i)(C) of this section (Example 1).

(iii) *Example 3 (Termination before the close of the calendar year ending in the taxable year of termination)*—(A) *Facts.* Assume the same facts as in paragraph (c)(4)(i)(A) of this section (Example 1). In addition, ATEO 1 has a termination of ATEO status on September 30, 2024.

(B) *Conclusion.* For ATEO 1's taxable year beginning July 1, 2024, and ending September 30, 2024, ATEO 1's applicable year is the period beginning January 1, 2024, and ending September 30, 2024.

(iv) *Example 4 (Termination after the close of the calendar year ending in the taxable year of termination)*—(A) *Facts.* Assume the same facts as in

paragraph (c)(4)(i)(A) of this section (Example 1). In addition, ATEO 1 has a termination of ATEO status on March 31, 2025.

(B) *Conclusion.* For ATEO 1's taxable year beginning July 1, 2024, and ending March 31, 2025, ATEO 1 has two applicable years: the 2024 calendar year, and the period beginning on January 1, 2025, and ending on March 31, 2025.

(d) *Covered employee*—(1) *In general.* For each taxable year, *covered employee* means any individual who is one of the five highest-compensated employees of the ATEO for the taxable year or was a covered employee of the ATEO (or any predecessor) for any preceding taxable year beginning after December 31, 2016.

(2) *Five highest-compensated employees*—(i) *In general.* Except as otherwise provided in this paragraph (d)(2), an individual is one of an ATEO's five highest-compensated employees for the taxable year if the individual is among the five employees of the ATEO with the highest amount of remuneration paid during the applicable year, as determined under §53.4960-2. However, remuneration for which the deduction is disallowed by reason of section 162(m) is taken into account for purposes of determining an ATEO's five highest-compensated employees. The five highest-compensated employees of an ATEO for the taxable year are identified on the basis of the total remuneration paid during the applicable year to the employee for services performed as an employee of the ATEO or any related organization. An ATEO may have fewer than five highest-compensated employees for a taxable year if it has fewer than five employees other than employees who are disregarded under paragraphs (d)(2)(ii) through (iv) of this section. For purposes of this paragraph (d)(2), a grant of a legally binding right (within the meaning of §1.409A-1(b)) to vested remuneration is considered to be remuneration paid as of the date of grant, as described in §53.4960-2(c)(2), and a person or governmental entity is considered to grant a legally binding right to nonvested remuneration if the person or governmental entity grants a legally binding right to remuneration that is not vested within the meaning of §53.4960-2(c)(2). An employee is disregarded for purposes of determining an ATEO's five highest-compensated employees for a taxable year if, during the applicable year, neither the ATEO nor any related organization

paid remuneration or granted a legally binding right to nonvested remuneration to the individual for services the individual performed as an employee of the ATEO or any related organization.

(ii) *Limited hours exception*—(A) *In general.* An individual is disregarded for purposes of determining an ATEO's five highest-compensated employees for a taxable year if all of the following requirements are met:

(1) *Remuneration requirement.* Neither the ATEO nor any related ATEO paid remuneration or granted a legally binding right to nonvested remuneration to the individual for services the individual performed as an employee of the ATEO during the applicable year; and

(2) *Hours of service requirement.* The individual performed services as an employee of the ATEO and all related ATEOs for no more than 10 percent of the total hours the individual worked as an employee of the ATEO and any related organizations during the applicable year. An ATEO may instead make this determination based on the total days the individual worked as an employee of the ATEO and all related ATEOs as a percentage of the total days worked as an employee of the ATEO and all related organizations, provided that for purposes of the calculation, any day that the individual worked at least one hour as an employee of the ATEO or a related ATEO is treated as a day worked as an employee of the ATEO and not for any other organization.

(B) *Certain payments disregarded.* For purposes of paragraph (d)(2)(ii)(A)(1) of this section, a payment of remuneration made to the individual by a related organization that is an employer of the individual and for which the related organization is neither entitled to reimbursement by the ATEO nor entitled to any other consideration from the ATEO is not considered remuneration paid by the ATEO under §53.4960-2(b)(1), and a payment of remuneration made to the individual by a related organization is not treated as remuneration paid by the ATEO under §53.4960-2(b)(2).

(C) *Safe harbor.* For purposes of paragraph (d)(2)(ii)(A)(2) of this section, an individual is treated as having performed services as an employee of the ATEO and all related ATEOs for no more than 10

percent of the total hours the individual worked as an employee of the ATEO and all related organizations during the applicable year if the employee performed no more than 100 hours of service as an employee of the ATEO and all related ATEOs during the applicable year.

(iii) *Nonexempt funds exception*—(A) *In general.* An individual is disregarded for purposes of determining an ATEO's five highest-compensated employees for a taxable year if all the following requirements are met:

(1) *Remuneration requirement.* Neither the ATEO, nor any related ATEO, nor any taxable related organization controlled by the ATEO, or by one or more related ATEOs, either alone or together with the ATEO, paid remuneration or granted a legally binding right to nonvested remuneration to the individual for services the individual performed as an employee of an ATEO during the applicable year and the preceding applicable year. For this purpose, whether a taxable related organization is controlled by the ATEO (or one or more related ATEOs) is determined without regard to paragraph (i)(2)(vii)(B) (2) of this section and without regard to section 318(a)(3) for purposes of applying paragraph (i)(2)(vii)(A) of this section, so that an interest in a corporation or nonstock entity is not attributed downward in determining control of the corporation or nonstock entity;

(2) *Hours of service requirement.* The individual performed services as an employee of the ATEO and any related ATEOs for not more than 50 percent of the total hours worked as an employee of the ATEO and any related organizations during the applicable year and the preceding applicable year. An ATEO may instead make this determination based on the total days the individual worked as an employee of the ATEO and all related ATEOs as a percentage of the total days worked as an employee of the ATEO and all related organizations, provided that for purposes of the calculation, any day that the individual worked at least one hour as an employee of the ATEO or a related ATEO is treated as a day worked as an employee of the ATEO and not for any other organization; and

(3) *Related organizations requirement.* No related organization that paid

remuneration or granted a legally binding right to nonvested remuneration to the individual during the applicable year and the preceding applicable year provided services for a fee to the ATEO, to any related ATEO, or to any taxable related organization controlled by the ATEO or by one or more related ATEOs, either alone or together with the ATEO, during the applicable year and the preceding applicable year. For purposes of this paragraph (d)(2)(iii)(A)(3), whether a taxable related organization is controlled by the ATEO (or one or more related ATEOs) is determined without regard to paragraph (i)(2)(vii)(B) (2) of this section and without regard to section 318(a)(3) for purposes of applying paragraph (i)(2)(vii)(A) of this section, so that an interest in a corporation or nonstock entity is not attributed downward in determining control of the corporation or nonstock entity.

(B) *Certain payments disregarded.* For purposes of paragraph (d)(2)(iii)(A)(1) of this section, a payment of remuneration made to an individual by a related organization that is an employer of the individual and for which the related organization is neither entitled to reimbursement by the ATEO nor entitled to any other consideration from the ATEO is not considered remuneration paid by the ATEO under §53.4960-2(b)(1) and a payment of remuneration made to the individual by a related organization is not treated as paid by the ATEO under §53.4960-2(b)(2).

(iv) *Limited services exception.* An individual is disregarded for purposes of determining an ATEO's five highest-compensated employees for a taxable year even though the ATEO paid remuneration to the individual if, disregarding §53.4960-2(b)(2), all of the following requirements are met:

(A) *Remuneration requirement.* The ATEO did not pay 10 percent or more of the individual's total remuneration for services performed as an employee of the ATEO and all related organizations during the applicable year; and

(B) *Related ATEO requirement.* The ATEO had at least one related ATEO during the applicable year and one of the following conditions applies:

(1) *Ten percent remuneration condition.* A related ATEO paid at least 10 percent of the remuneration paid by the ATEO

and any related organizations during the applicable year; or

(2) *Less remuneration condition.* No related ATEO paid at least 10 percent of the total remuneration paid by the ATEO and any related organizations and the ATEO paid less remuneration to the individual than at least one related ATEO during the applicable year.

(3) *Examples.* The following examples illustrate the rules of this paragraph (d). For purposes of these examples, assume any entity referred to as “ATEO” is an ATEO, any entity referred to as “CORP” is not an ATEO and is not a publicly held company within the meaning of section 162(m)(2) unless otherwise stated, and each taxpayer uses the calendar year as its taxable year.

(i) *Example 1 (Employee of two related ATEOs)*—(A) *Facts.* ATEO 1 and ATEO 2 are related organizations and have no other related organizations. Both employ Employee A during calendar year 2022 and pay remuneration to Employee A for Employee A’s services. During 2022, Employee A performed services for 1,000 hours as an employee of ATEO 1 and 1,000 hours as an employee of ATEO 2.

(B) *Conclusion.* Employee A may be a covered employee of both ATEO 1 and ATEO 2 as one of the five highest-compensated employees for taxable year 2022 under paragraph (d)(2)(i) of this section because the exceptions in paragraphs (d)(2)(ii) through (iv) of this section do not apply. Because they are related organizations, ATEO 1 and ATEO 2 must each include the remuneration paid to Employee A by the other during each of their applicable years in determining their respective five highest-compensated employees for taxable year 2022.

(ii) *Example 2 (Employee of an ATEO and a related non-ATEO)*—(A) *Facts.* Assume the same facts as in paragraph (d)(3)(i) of this section (*Example 1*), except that ATEO 1 is instead CORP 1.

(B) *Conclusion (CORP 1).* For taxable year 2022, CORP 1 is not an ATEO and therefore does not need to identify covered employees.

(C) *Conclusion (ATEO 2).* Employee A may be a covered employee of ATEO 2 as one of its five highest-compensated employees for taxable year 2022 under paragraph (d)(2)(i) of this section because no exception in paragraphs (d)(2)(ii) through (iv) of this section applies. ATEO 2 must include the remuneration paid to Employee A by CORP 1 during its applicable year in determining ATEO 2’s five highest-compensated employees for taxable year 2022.

(iii) *Example 3 (Amounts for which a deduction is disallowed under section 162(m) are taken into account for purposes of determining the five highest-compensated employees)*—(A) *Facts.* CORP 2 is a publicly held corporation within the meaning of section 162(m)(2) and is a related organization of ATEO 3. ATEO 3 is a corporation that is part of CORP 2’s affiliated group (as defined in section 1504, without regard to section 1504(b)) and has no other related organizations. Employee B is a covered employee (as defined in section 162(m)(3)) of CORP

2 and an employee of ATEO 3. In 2022, CORP 2 paid Employee B \$8 million of remuneration for services provided as an employee of CORP 2 and ATEO 3 paid Employee B \$500,000 of remuneration for services provided as an employee of ATEO 3. \$7.5 million of the remuneration is compensation for which a deduction is disallowed pursuant to section 162(m)(1).

(B) *Conclusion.* The \$7.5 million of remuneration for which a deduction is disallowed under section 162(m)(1) is taken into account for purposes of determining ATEO 3’s five highest-compensated employees. Thus, ATEO 3 is treated as paying Employee B \$8.5 million of remuneration for purposes of determining its five highest-compensated employees.

(iv) *Example 4 (Employee disregarded due to receiving no remuneration)*—(A) *Facts.* Employee C is an officer of ATEO 4 who performs more than minor services for ATEO 4. In 2022, neither ATEO 4 nor any related organization paid remuneration or granted a legally binding right to any nonvested remuneration to Employee C. ATEO 4 paid premiums for insurance for liability arising from Employee C’s service with ATEO 4, which is properly treated as a working condition fringe benefit excluded from gross income under §1.132-5.

(B) *Conclusion.* Even though Employee C is an employee of ATEO 4, Employee C is disregarded for purposes of determining ATEO 4’s five highest-compensated employees for taxable year 2022 under paragraph (d)(2)(i) of this section because neither ATEO 4 nor any related organization paid Employee C any remuneration (nor did they grant a legally binding right to nonvested remuneration) in applicable year 2022. The working condition fringe benefit is not wages within the meaning of section 3401(a), as provided in section 3401(a)(19), and thus is not remuneration within the meaning of §53.4960-2(a).

(v) *Example 5 (Limited hours exception)*—(A) *Facts.* ATEO 5 and CORP 3 are related organizations. ATEO 5 has no other related organizations. Employee D is an employee of CORP 3. As part of Employee D’s duties at CORP 3, Employee D serves as an officer of ATEO 5. Only CORP 3 paid remuneration (or granted a legally binding right to nonvested remuneration) to Employee D and ATEO 5 did not reimburse CORP 3 for any portion of Employee D’s remuneration in any manner. During 2022, Employee D provided services as an employee for 2,000 hours to CORP 3 and 200 hours to ATEO 5.

(B) *Conclusion.* Even though Employee D is an employee of ATEO 5 because Employee D provided more than minor services as an officer, Employee D is disregarded for purposes of determining ATEO 5’s five highest-compensated employees for taxable year 2022. Employee D is disregarded under paragraph (d)(2)(ii) of this section because only CORP 3 paid Employee D any remuneration or granted a legally binding right to nonvested remuneration in applicable year 2022 and Employee D provided services as an employee of ATEO 5 for 200 hours, which is not more than ten percent of the 2,200 total hours (2,000 + 200 = 2,200) worked as an employee of ATEO 5 and all related organizations.

(vi) *Example 6 (Limited hours exception)*—(A) *Facts.* Assume the same facts as in paragraph (d)(3)(v) of this section (*Example 5*), except that ATEO 5

also provides a reasonable allowance for expenses incurred by Employee D in executing Employee D’s duties as an officer of ATEO 5, which is properly excluded from gross income under an accountable plan described in §1.62-2.

(B) *Conclusion.* The conclusion is the same as in paragraph (d)(3)(v)(B) of this section (*Example 5*). Specifically, even though Employee D is an employee of ATEO 5 because Employee D provided more than minor services for ATEO 5, Employee D is disregarded for purposes of determining ATEO 5’s five highest-compensated employees for taxable year 2022 under paragraph (d)(2)(ii) of this section because the expense allowance under the accountable plan is excluded from wages within the meaning of section 3401(a), as provided in §31.3401(a)-4, and thus is not remuneration within the meaning of §53.4960-2(a).

(vii) *Example 7 (No exception applies due to source of payment)*—(A) *Facts.* Assume the same facts as in paragraph (d)(3)(v) of this section (*Example 5*), except that ATEO 5 has a contractual arrangement with CORP 3 to reimburse CORP 3 for the hours of service Employee D provides to ATEO 5 during applicable year 2022 by paying an amount equal to the total remuneration received by Employee D from both ATEO 5 and CORP 3, multiplied by a fraction equal to the hours of service Employee D provided ATEO 5 over Employee D’s total hours of service to both ATEO 5 and CORP 3.

(B) *Conclusion.* Employee D may be one of ATEO 5’s five highest-compensated employees for taxable year 2022 under paragraph (d)(2)(i) of this section because the exceptions in paragraphs (d)(2)(ii) through (iv) of this section do not apply. Pursuant to the contractual arrangement between CORP 3 and ATEO 5, ATEO 5 reimburses CORP 3 for a portion of Employee D’s remuneration during applicable year 2022; thus, the exceptions under paragraphs (d)(2)(ii) and (iii) of this section do not apply. Further, while ATEO 5 paid Employee D less than 10 percent of the total remuneration from ATEO 5 and all related organizations (200 hours of service to ATEO 5 / 2,200 hours of service to ATEO 5 and all related organizations = 9 percent), it had no related ATEO; thus, the limited services exception under paragraph (d)(2)(iv) of this section does not apply.

(viii) *Example 8 (Nonexempt funds exception for part-time services)*—(A) *Facts.* ATEO 6 and CORP 4 are related organizations. ATEO 6 has no other related organizations and does not control CORP 4. During applicable year 2022, Employee E provided 2,000 hours of services as an employee of CORP 4 and 0 hours of services as an employee of ATEO 6; during applicable year 2023, Employee E provided 1,100 hours of services as an employee of CORP 4 and 900 hours of services as an employee of ATEO 6; during applicable year 2024, Employee E provided 1,100 hours of services as an employee of CORP 4 and 900 hours of services as an employee of ATEO 6. ATEO 6 neither paid any remuneration to Employee E nor paid a fee for services to CORP 4 during any applicable year. No exception under paragraphs (d)(2)(i), (ii), or (iv) applies to Employee E.

(B) *Conclusion (2023).* Employee E is disregarded for purposes of determining ATEO 6’s five highest-compensated employees for taxable year 2023 under paragraph (d)(2)(iii) of this section be-

cause for applicable years 2022 and 2023, Employee E provided services as an employee of ATEO 6 for not more than 50 percent of the total hours Employee E provided services as an employee of ATEO 6 and CORP 4 (900 hours / 4,000 hours), and ATEO 6 neither paid any remuneration to Employee E nor paid a fee for services to CORP 4 during applicable years 2022 and 2023.

(C) *Conclusion (2024)*. Employee E is disregarded for purposes of determining ATEO 6's five highest-compensated employees for taxable year 2024 under paragraph (d)(2)(iii) of this section because for applicable years 2023 and 2024, Employee E provided services as an employee of ATEO 6 for not more than 50 percent of the total hours Employee E provided services as an employee of ATEO 6 and CORP 4 (1,800 hours / 4,000 hours), and ATEO 6 neither paid any remuneration to Employee E nor paid a fee for services to CORP 4 during applicable years 2023 and 2024.

(ix) *Example 9 (Nonexempt funds for full-time services in one applicable year)*—(A) *Facts*. Assume the same facts as in paragraph (d)(3)(viii) of this section (*Example 8*), except that during applicable year 2022, Employee E provided services as an employee for 2,000 hours to CORP 4 and for 0 hours to ATEO 6; during applicable year 2023, Employee E provided services as an employee for 0 hours to CORP 4 and 2,000 hours to ATEO 6; and during applicable year 2024, Employee E resumes employment with CORP 4 so that Employee E provided services as an employee for 2,000 hours to CORP 4 and 0 hours to ATEO 6.

(B) *Conclusion (2023)*. Employee E is disregarded for purposes of determining ATEO 6's five highest-compensated employees for taxable year 2023 under paragraph (d)(2)(iii) of this section because for applicable years 2022 and 2023, Employee E provided services as an employee of ATEO 6 for not more than 50 percent of the total hours Employee E provided services as an employee of ATEO 6 and CORP 4 (2,000 hours / 4,000 hours), and ATEO 6 neither paid any remuneration to Employee E nor paid a fee for services to CORP 4 during applicable years 2022 and 2023.

(C) *Conclusion (2024)*. Employee E is disregarded for purposes of determining ATEO 6's five highest-compensated employees for taxable year 2024 under paragraph (d)(2)(iii) of this section because for applicable years 2023 and 2024, Employee E provided services as an employee of ATEO 6 for not more than 50 percent of the total hours Employee E provided services as an employee of ATEO 6 and CORP 4 (2,000 hours / 4,000 hours for ATEO 6 and CORP 4), and ATEO 6 neither paid any remuneration to Employee E nor paid a fee for services to CORP 4 during applicable years 2023 and 2024.

(x) *Example 10 (Nonexempt funds exception for full-time services across two applicable years)*—(A) *Facts*. Assume the same facts as in paragraph (d)(3)(viii)(A) of this section (*Example 8*), except that during applicable year 2022, Employee E provided services as an employee for 2,000 hours to CORP 4 and for 0 hours to ATEO 6; during applicable year 2023, Employee E provided services as an employee for 600 hours to CORP 4 and for 1,400 hours to ATEO 6; and during applicable year 2024, Employee E provided services as an employee for 1,400 hours to CORP 4 and for 600 hours to ATEO 6.

(B) *Conclusion (2023)*. Employee E is disregarded for purposes of determining ATEO 6's five highest-compensated employees for taxable year 2023 under paragraph (d)(2)(iii) of this section because for applicable years 2022 and 2023, Employee E provided services as an employee of ATEO 6 for not more than 50 percent of the total hours Employee E provided services as an employee of ATEO 6 and CORP 4 (1,400 hours / 4,000 hours), and ATEO 6 neither paid any remuneration to Employee E, nor paid a fee for services to CORP 4 during applicable years 2022 and 2023.

(C) *Conclusion (2024)*. Employee E is disregarded for purposes of determining ATEO 6's five highest-compensated employees for taxable year 2024 under paragraph (d)(2)(iii) of this section because for applicable years 2023 and 2024, Employee E provided services as an employee of ATEO 6 for not more than 50 percent of the total hours Employee E provided services as an employee of ATEO 6 and CORP 4 (2,000 hours / 4,000 hours), and ATEO 6 neither paid any remuneration to Employee E, nor paid a fee for services to CORP 4 during applicable years 2023 and 2024.

(xi) *Example 11 (Failure under the nonexempt funds exception)*—(A) *Facts*. Assume the same facts as in paragraph (d)(3)(viii)(A) of this section (*Example 8*), except that during applicable year 2022, Employee E provided services as an employee for 2,000 hours to CORP 4 and for 0 hours to ATEO 6; during applicable year 2023, Employee E provided services as an employee for 600 hours to CORP 4 and for 1,400 hours to ATEO 6; and during applicable year 2024, Employee E provided services as an employee for 1,300 hours to CORP 4 and for 700 hours to ATEO 6.

(B) *Conclusion (2023)*. Employee E is disregarded for purposes of determining ATEO 6's five highest-compensated employees for taxable year 2023 under paragraph (d)(2)(iii) of this section because for applicable years 2022 and 2023, Employee E provided services as an employee of ATEO 6 for less than 50 percent of the total hours Employee E provided services as an employee of ATEO 6 and CORP 4 (1,400 hours / 4,000 hours), and ATEO 6 neither paid any remuneration to Employee E, nor paid a fee for services to CORP 4 during applicable years 2022 and 2023.

(C) *Conclusion (2024)*. Employee E may be a covered employee of ATEO 6 as one of its five highest-compensated employees for taxable year 2024 because the requirements under paragraph (d)(2)(iii) are not met and no other exception applies. For applicable years 2023 and 2024, Employee E provided services as an employee of ATEO 6 for more than 50 percent of the total hours Employee E provided services as an employee of ATEO 6 and CORP 4 (2,100 hours / 4,000 hours).

(xii) *Example 12 (Limited services exception)*—(A) *Facts*. ATEO 7, ATEO 8, ATEO 9, and ATEO 10 are a group of related organizations, none of which have any other related organizations. During 2022, Employee F is an employee of ATEO 7, ATEO 8, ATEO 9, and ATEO 10. During applicable year 2022, ATEO 7 paid 5 percent of Employee F's remuneration, ATEO 8 paid 10 percent of Employee F's remuneration, ATEO 9 paid 25 percent of Employee F's remuneration, and ATEO 10 paid 60 percent of Employee F's remuneration. No exception under

paragraph (d)(2)(i), (ii), or (iii) applies to Employee F for any of ATEO 7, ATEO 8, ATEO 9, or ATEO 10.

(B) *Conclusion (ATEO 7)*. Employee F is disregarded for purposes of determining ATEO 7's five highest-compensated employees for taxable year 2022 under paragraph (d)(2)(iv) of this section because ATEO 7 paid less than 10 percent of Employee F's total remuneration from ATEO 7 and all related organizations during applicable year 2022, and another related ATEO paid at least 10 percent of that total remuneration.

(C) *Conclusion (ATEO 8, ATEO 9, and ATEO 10)*. Employee F may be a covered employee of ATEO 8, ATEO 9, and ATEO 10 as one of their respective five highest-compensated employees for their taxable years 2022 because each of those ATEOs paid 10 percent or more of Employee F's remuneration during the 2022 applicable year. Thus, the limited services exception under paragraph (d)(2)(iv) of this section does not apply.

(xiii) *Example 13 (Limited services exception if no ATEO paid at least 10 percent of remuneration)*—(A) *Facts*. Assume the same facts as in paragraph (d)(3)(xii) of this section (*Example 12*), except that for applicable year 2022, ATEO 7 paid 6 percent of F's remuneration, ATEO 8, ATEO 9, and ATEO 10 each paid 5 percent of Employee F's remuneration, and Employee F also works as an employee of CORP 5, a related organization of ATEO 7, ATEO 8, ATEO 9, and ATEO 10 that paid 79 percent of Employee F's remuneration for applicable year 2022.

(B) *Conclusion (ATEO 7)*. Employee F may be one of ATEO 7's five highest-compensated employees for taxable year 2022. Although ATEO 7 did not pay Employee F 10 percent or more of the total remuneration paid by ATEO 7 and all of its related organizations, no related ATEO paid more than 10 percent of Employee F's remuneration, and ATEO 7 did not pay less remuneration to Employee F than at least one related ATEO. Thus, the limited services exception under paragraph (d)(2)(iv) of this section does not apply, and Employee F may be one of ATEO 7's five highest-compensated employees because ATEO 7 paid Employee F more remuneration than any other related ATEO.

(C) *Conclusion (ATEO 8, ATEO 9, and ATEO 10)*. Employee F is disregarded for purposes of determining the five highest-compensated employees of ATEO 8, ATEO 9, and ATEO 10 for taxable year 2022 under paragraph (d)(2)(iv) of this section because none paid 10 percent or more of Employee F's total remuneration, each had no related ATEO that paid at least 10 percent of Employee F's total remuneration, and each paid less remuneration than at least one related ATEO (ATEO 7).

(e) *Employee*—(1) *In general*. *Employee* means an employee as defined in section 3401(c) and §31.3401(c)-1. Section 31.3401(c)-1 generally defines an employee as any individual performing services if the relationship between the individual and the person for whom the individual performs services is the legal relationship of employer and employee. As set forth in §31.3401(c)-1, this includes common law employees, as well as

officers and employees of government entities, whether or not elected. An employee generally also includes an officer of a corporation, but an officer of a corporation who as such does not perform any services or performs only minor services and who neither receives, nor is entitled to receive, any remuneration is not considered to be an employee of the corporation solely due to the individual's status as an officer of the corporation. Whether an individual is an employee depends on the facts and circumstances.

(2) *Directors.* A director of a corporation (or an individual holding a substantially similar position in a corporation or other entity) in the individual's capacity as such is not an employee of the corporation. See §31.3401(c)-1(f).

(3) *Trustees.* The principles of paragraph (e)(2) of this section apply by analogy to a trustee of any arrangement classified as a trust for Federal tax purposes in §301.7701-4(a).

(f) *Employer*—(1) *In general.* *Employer* means an employer within the meaning of section 3401(d), without regard to section 3401(d)(1) or (2), meaning generally the person or governmental entity for whom the services were performed as an employee. Whether a person or governmental entity is the employer depends on the facts and circumstances, but a person does not cease to be the employer through use of a payroll agent under section 3504, a common paymaster under section 3121(s), a person described in section 3401(d)(1) or (2), a certified professional employer organization under section 7705, or any similar arrangement.

(2) *Disregarded entities.* In the case of a disregarded entity described in §301.7701-3, §301.7701-2(c)(2)(iv) does not apply; thus, the sole owner of the disregarded entity is treated as the employer of any individual performing services as an employee of the disregarded entity.

(g) *Medical services*—(1) *Medical and veterinary services*—(i) *In general.* *Medical services* means services directly performed by a licensed medical professional (as defined in paragraph (g)(2) of this section) for the diagnosis, cure, mitigation, treatment, or prevention of disease in humans or animals; services provided for the purpose of affecting any structure or function of the human or animal body;

and other services integral to providing such medical services. For purposes of section 4960, teaching and research services are not medical services except to the extent that they involve the services performed to directly diagnose, cure, mitigate, treat, or prevent disease or affect a structure or function of the body. Administrative services may be integral to directly providing medical services. For example, documenting the care and condition of a patient is integral to providing medical services, as is accompanying another licensed professional as a supervisor while that medical professional provides medical services. However, managing an organization's operations, including scheduling, staffing, appraising employee performance, and other similar functions that may relate to a particular medical professional or professionals who perform medical services, is not integral to providing medical services. See §53.4960-2(a)(2)(ii) for rules regarding allocating remuneration paid to a medical professional who performs both medical services and other services.

(ii) *Examples.* The following examples illustrate the rules of this paragraph (g):

(A) *Example 1 (Administrative tasks that are integral to providing medical services)*—(1) *Facts.* Employee A is a doctor who is licensed to practice medicine in the state in which Employee A's place of employment is located. In the course of Employee A's practice, Employee A treats patients and performs some closely-related administrative tasks, such as examining and updating patient records.

(2) *Conclusion.* Employee A's administrative tasks are integral to providing medical services and thus are medical services.

(B) *Example 2 (Administrative tasks that are not integral to providing medical services)*—(1) *Facts.* Assume the same facts as in paragraph (g)(1)(ii)(A) (1) of this section (Example 1), except that Employee A also performs additional administrative tasks such as analyzing the budget, authorizing capital expenditures, and managing human resources for the organization by which Employee A is employed.

(2) *Conclusion.* Employee A's additional administrative tasks are not integral to providing medical services and thus are not medical services.

(C) *Example 3 (Teaching duties that are and are not medical services)*—(1) *Facts.* Employee B is a medical doctor who is licensed to practice medicine in the state in which her place of employment, a university hospital, is located. Employee B's duties include overseeing and teaching a group of resident physicians who have restricted licenses to practice medicine. Those duties include supervising and instructing the resident physicians while they treat patients and instruction in a classroom setting.

(2) *Conclusion.* Employee B's supervision and instruction of resident physicians during the course

of patient treatment are necessary for the treatment, and thus are medical services. Employee B's classroom instruction is not necessary for patient treatment, and thus is not medical services.

(D) *Example 4 (Research services that are and are not medical services)*—(1) *Facts.* Employee C is a licensed medical doctor who is employed to work on a research trial. Employee C provides an experimental treatment to patients afflicted by a disease and performs certain closely-related administrative tasks that ordinarily are performed by a medical professional in a course of patient treatment. As part of the research trial, Employee C also compiles and analyzes patient results and prepares reports and articles that would not ordinarily be prepared by a medical professional in the course of patient treatment.

(2) *Conclusion.* Employee C's services that are ordinarily performed by a medical professional in a course of treatment, including closely-related administrative tasks, are medical services. Because the compilation and analysis of patient results and the formulation of reports and articles are neither services ordinarily performed by a medical professional in a course of treatment nor necessary for such treatment, these services are not medical services.

(2) *Definition of licensed medical professional.* *Licensed medical professional* means an individual who is licensed under applicable state or local law to perform medical services, including as a doctor, nurse, nurse practitioner, dentist, veterinarian, or other licensed medical professional.

(h) *Predecessor*—(1) *Asset acquisitions.* If an ATEO (acquiror) acquires at least 80 percent of the operating assets or total assets (determined by fair market value on the date of acquisition) of another ATEO (target), then the target is a predecessor of the acquiror. For an acquisition of assets that occurs over time, only assets acquired within a 12-month period are taken into account to determine whether at least 80 percent of the target's operating assets or total assets were acquired. However, this 12-month period is extended to include any continuous period that ends or begins on any day during which the acquiror has an arrangement to acquire directly or indirectly, assets of the target. Additions to the assets of target made as part of a plan or arrangement to avoid the application of this subsection to acquiror's purchase of target's assets are disregarded in applying this paragraph. This paragraph (h)(1) applies for purposes of determining whether an employee is a covered employee under paragraph (d)(1) of this section only with respect to a covered employee of the target who commences the

performance of services for the acquiror (or a related organization with respect to the acquiror) within the period beginning 12 months before and ending 12 months after the date of the transaction as defined in paragraph (h)(7) of this section.

(2) *Corporate reorganizations.* A predecessor of an ATEO includes another separate ATEO the stock or assets of which are acquired in a corporate reorganization as defined in section 368(a)(1) (A), (C), (D), (E), (F), or (G) (including by reason of section 368(a)(2)).

(3) *Predecessor change of form or of place of organization.* An ATEO that restructured by changing its organizational form or place of organization (or both) is a predecessor of the restructured ATEO.

(4) *ATEO that becomes a non-ATEO—*

(i) *General rule.* An organization is a predecessor of an ATEO if it ceases to be an ATEO and then again becomes an ATEO effective on or before the predecessor end date. The *predecessor end date* is the date that is 36 months following the date that the organization's Federal information return under section 6033 (or, for an ATEO described in paragraph (b)(1)(ii) or (iii) of this section, its Federal income tax return under section 6011(a)) is due (or would be due if the organization were required to file), excluding any extension, for the last taxable year for which the organization previously was an ATEO. If the organization becomes an ATEO again effective after the predecessor end date, then the former ATEO is treated as a separate organization that is not a predecessor of the current ATEO.

(ii) *Intervening changes or entities.* If an ATEO that ceases to be an ATEO (former ATEO) would be treated as a predecessor to an organization that becomes an ATEO before the predecessor end date (successor ATEO), and if the former ATEO would be treated as a predecessor to each intervening entity (if such intervening entities had been ATEOs) under the rules of this paragraph (h), then the former ATEO is a predecessor of the successor ATEO. For example, if ATEO 1 loses its tax-exempt status and then merges into Corporation X, Corporation X then merges into Corporation Y, and Corporation Y becomes an ATEO before the predecessor end date, then ATEO 1 is a predecessor of Corporation Y.

(5) *Predecessor of a predecessor.* A reference to a predecessor includes any predecessor or predecessors of such predecessor, as determined under these rules.

(6) *Elections under sections 336(e) and 338.* For purposes of this paragraph (h), when an ATEO organized as a corporation makes an election to treat as an asset purchase either the sale, exchange, or distribution of stock pursuant to regulations under section 336(e) or the purchase of stock pursuant to regulations under section 338, the corporation that issued the stock is treated as the same corporation both before and after such transaction.

(7) *Date of transaction.* For purposes of this paragraph (h), the date that a transaction is treated as having occurred is the date on which all events necessary to complete the transaction described in the relevant provision have occurred.

(i) *Related organization—(1) In general.* Related organization means any person or governmental entity, domestic or foreign, that meets any of the following tests:

(i) *Controls or controlled by test.* The person or governmental entity controls, or is controlled by, the ATEO;

(ii) *Controlled by same persons test.* The person or governmental entity is controlled by one or more persons that control the ATEO;

(iii) *Supported organization test.* The person or governmental entity is a supported organization (as defined in section 509(f)(3)) with respect to the ATEO;

(iv) *Supporting organization test.* The person or governmental entity is a supporting organization described in section 509(a)(3) with respect to the ATEO; or

(v) *VEBA test.* With regard to an ATEO that is a voluntary employees' beneficiary association (VEBA) described in section 501(c)(9), the person or governmental entity establishes, maintains, or makes contributions to such VEBA.

(2) *Control—(i) In general.* Control may be direct or indirect. For rules concerning application of the principles of section 318 in applying this paragraph (i) (2), see paragraph (i)(2)(vii) of this section.

(ii) *Stock corporation.* A person or governmental entity controls a stock corporation if it owns (by vote or value) more

than 50 percent of the stock in the stock corporation.

(iii) *Partnership.* A person or governmental entity controls a partnership if it owns more than 50 percent of the profits interests or capital interests in the partnership, determined in accordance with the rules and principles of §1.706-1(b)(4)(ii) for a partner's interest in the profits of a partnership and §1.706-1(b)(4)(iii) for a partner's interest in the capital of a partnership.

(iv) *Trust.* A person or governmental entity controls a trust if it owns more than 50 percent of the beneficial interests in the trust, determined by actuarial value.

(v) *Nonstock organization—(A) In general.* A person or governmental entity controls a nonstock organization if more than 50 percent of the trustees or directors of the nonstock organization are either representatives of, or directly or indirectly controlled by, the person or governmental entity. A *nonstock organization* is a non-profit organization or other organization without owners and includes a governmental entity.

(B) *Control of a trustee or director of a nonstock organization.* A person or governmental entity controls a trustee or director of the nonstock organization if the person or governmental entity has the power (either at will or at regular intervals) to remove such trustee or director and designate a new one.

(C) *Representatives.* Trustees, directors, officers, employees, or agents of a person or governmental entity are deemed representatives of the person or governmental entity. However, an employee of a person or governmental entity (other than a trustee, director, or officer, or an employee who possesses at least the authority commonly exercised by an officer) who is a director or trustee of a nonstock organization (or acting in that capacity) will not be treated as a representative of the person or governmental entity if the employee does not act as a representative of the person or governmental entity and that fact is reported in the form and manner prescribed by the Commissioner in forms and instructions.

(vi) *Brother-sister related organizations.* Under paragraph (i)(1)(ii) of this section, an organization is a related organization with respect to an ATEO if one or

more persons control both the ATEO and the other organization. In the case of control by multiple persons, the control tests described in this paragraph (i)(2) of this section apply to the persons as a group. For example, if 1,000 individuals who are members of both ATEO 1 and ATEO 2 elect a majority of the board members of each organization, then ATEO 1 and ATEO 2 are related to each other because the same group of 1,000 persons controls both ATEO 1 and ATEO 2.

(vii) *Section 318 principles*—(A) *In general.* Section 318 (relating to constructive ownership of stock) applies in determining ownership of stock in a corporation. The principles of section 318 also apply for purposes of determining ownership of interests in a partnership or in a trust with beneficial interests. For example, applying the principles of section 318(a)(1)(A), an individual is considered to own the partnership interest or trust interest owned, directly or indirectly, by or for the family members specified in such section.

(B) *Nonstock organizations*—(1) *Attribution of ownership interest from a nonstock organization to a controlling person.* If a person or governmental entity controls a nonstock organization, the person or governmental entity is treated as owning a percentage of the stock (or partnership interest or beneficial interest in a trust) owned by the nonstock organization in accordance with the percentage of trustees or directors of the nonstock organization that are representatives of, or directly or indirectly controlled by, the person or governmental entity.

(2) *Attribution of ownership interest from a controlling person to a nonstock organization.* If a person or governmental entity controls a nonstock organization, the nonstock organization is treated as owning a percentage of the stock (or partnership interest or beneficial interest in a trust) owned by the person or governmental entity in accordance with the percentage of trustees or directors of the nonstock organization that are representatives of, or directly or indirectly controlled by, the person or governmental entity.

(3) *Indirect control of a nonstock organization through another nonstock organization.* If a person or governmental entity controls one nonstock organization

that controls a second nonstock organization, the person or governmental entity is treated as controlling the second nonstock organization if the product of the percentage of trustees or directors of the first nonstock organization that are representatives of, or directly or indirectly controlled by, the person or governmental entity, multiplied by the percentage of trustees or directors of the second nonstock organization that are representatives of, or directly or indirectly controlled by, the person or governmental entity, exceeds 50 percent. Similar principles apply to successive tiers of nonstock organizations.

(4) *Attribution of control of nonstock organization to family member.* An individual's control of a nonstock organization or of a trustee or director of a nonstock organization is attributed to the members of the individual's family (as set forth in section 318(a)(1) and the regulations thereunder), subject to the limitation of section 318(a)(5)(B) and the regulations thereunder.

(3) *Examples.* The following examples illustrate the principles of this paragraph (i). For purposes of these examples, assume any entity referred to as "ATEO" is an ATEO and any entity referred to as "CORP" is not an ATEO.

(i) *Example 1 (Related through a chain of control)*—(A) *Facts.* ATEO 1, ATEO 2, and ATEO 3 are nonstock organizations. ATEO 3 owns 80 percent of the stock (by value) of corporation CORP 1. Eighty percent of ATEO 2's directors are representatives of ATEO 1. In addition, 80 percent of ATEO 3's directors are representatives of ATEO 1.

(B) *Conclusion.* ATEO 1 is a related organization with respect to ATEO 2 (and vice versa) because more than 50 percent of ATEO 2's directors are representatives of ATEO 1; thus, ATEO 1 controls ATEO 2. Based on the same analysis, ATEO 1 is also a related organization with respect to ATEO 3 (and vice versa). CORP 1 is a related organization with respect to ATEO 3 because, as the owner of more than 50 percent of CORP 1's stock, ATEO 3 controls CORP 1. Applying the principles of section 318, ATEO 1 is deemed to own 64 percent of the stock of CORP 1 (80 percent of ATEO 3's stock in CORP 1). Thus, CORP 1 is a related organization with respect to ATEO 1 because ATEO 1 controls CORP 1. ATEO 2 is a related organization with respect to ATEO 3, ATEO 3 is a related organization with respect to ATEO 2, and CORP 1 is a related organization with respect to ATEO 2 because ATEO 2, ATEO 3, and CORP 1 are all controlled by the same person (ATEO 1).

(ii) *Example 2 (Not related through a chain of control)*—(A) *Facts.* ATEO 4, ATEO 5, and ATEO 6 are nonstock organizations. Sixty percent of ATEO

5's directors are representatives of ATEO 4. In addition, 60 percent of ATEO 6's directors are representatives of ATEO 5, but none are representatives of ATEO 4.

(B) *Conclusion.* ATEO 4 is a related organization with respect to ATEO 5 (and vice versa) because more than 50 percent of ATEO 5's directors are representatives of ATEO 4; thus, ATEO 4 controls ATEO 5. Based on the same analysis, ATEO 6 is a related organization with respect to ATEO 5 (and vice versa). Applying the principles of section 318, ATEO 4 is deemed to control 36 percent of ATEO 6's directors (60 percent of ATEO 5's 60 percent control over ATEO 6). Because less than 50 percent of ATEO 6's directors are representatives of ATEO 4, and absent any facts suggesting that ATEO 4 directly or indirectly controls ATEO 6, ATEO 4 and ATEO 6 are not related organizations with respect to each other.

§53.4960-2 Determination of remuneration paid for a taxable year.

(a) *Remuneration*—(1) *In general.* For purposes of section 4960, *remuneration* means any amount that is wages as defined in section 3401(a), excluding any designated Roth contribution (as defined in section 402A(c)) and including any amount required to be included in gross income under section 457(f). Remuneration includes amounts includible in gross income as compensation for services as an employee pursuant to a below-market loan described in section 7872(c)(1)(B) (i) (compensation-related loans) but does not include amounts excepted by section 7872(c)(3) (\$10,000 de minimis exception). For example, see §1.7872-15(e)(1) (i). Director's fees paid by a corporation to a director of the corporation are not remuneration, provided that if the director is also an employee of the corporation, the director's fees are excluded from remuneration only to the extent that they do not exceed fees paid to a director who is not an employee of the corporation or any related organization or, if there is no such director, they do not exceed reasonable director's fees. Remuneration does not include any amount that vested or was paid by a taxpayer before the start of the taxpayer's first taxable year that began on or after January 1, 2018.

(2) *Exclusion of remuneration for medical services*—(i) *In general.* Remuneration does not include the portion of any remuneration paid to a licensed medical professional that is for the performance of medical services by such professional.

(ii) *Allocation of remuneration for medical services and non-medical services.* If, during an applicable year, an employer pays a covered employee remuneration for providing both medical services and non-medical services, the employer must make a reasonable, good faith allocation between the remuneration for medical services and the remuneration for non-medical services. For example, if a medical doctor receives current remuneration (or vests in remuneration under a deferred compensation plan) for providing medical services and administrative or management services, the employer must make a reasonable, good faith allocation between the remuneration for the medical services and the remuneration for the administrative or management services. For this purpose, if an employment agreement or similar written arrangement sets forth the remuneration to be paid for particular services, that allocation of remuneration applies unless the facts and circumstances demonstrate that the amount allocated to medical services is unreasonable for those services or that the allocation was established for purposes of avoiding application of the excise tax under section 4960. If some or all of the remuneration is not reasonably allocated in an employment agreement or similar arrangement, an employer may use any reasonable allocation method. For example, an employer may use a representative sample of records, such as patient, insurance, and Medicare/Medicaid billing records or internal time reporting mechanisms to determine the time spent providing medical services, and then allocate remuneration to medical services in the proportion such time bears to the total hours the employee worked for the employer (and any related employer) for purposes of making a reasonable allocation of remuneration. Similarly, if some or all of the remuneration is not reasonably allocated in an employment agreement or other similar arrangement, an employer may use salaries or other remuneration paid by the employer or similarly situated employers for duties comparable to those the employee performs (for example, hospital administrator and physician) for purposes of making a reasonable allocation between remuneration for providing medical services and for providing non-medical services.

(iii) *Examples.* The following examples illustrate the rules of this paragraph (a)(2). For purposes of these examples, assume any entity referred to as “ATEO” is an ATEO.

(A) *Example 1 (Allocation based on employment agreement)*—(1) *Facts.* Employee A is a covered employee of ATEO 1. Employee A is a licensed medical professional who provides patient care services for ATEO 1 and also provides management and administrative services to ATEO 1 as the manager of a medical practice group within ATEO 1. The employment agreement between ATEO 1 and Employee A specifies that of Employee A’s salary, 30 percent is allocable to Employee A’s services as manager of the medical practice group and 70 percent is allocable to Employee A’s services as a medical professional providing patient care services. The facts regarding Employee A’s employment indicate the employment agreement provides a reasonable allocation and that the allocation was not established for purposes of avoiding application of the excise tax.

(2) *Conclusion.* Consistent with Employee A’s employment agreement, ATEO 1 must allocate 30 percent of Employee A’s salary to the provision of non-medical services and 70 percent of Employee A’s salary to the provision of medical services. Accordingly, only the 30 percent portion of Employee A’s salary allocated to the other, non-medical services is remuneration for purposes of paragraph (a) of this section.

(B) *Example 2 (Allocation based on billing records)*—(1) *Facts.* Assume the same facts as in paragraph (a)(2)(iii)(A) of this section (Example 1), except that the employment agreement does not allocate Employee A’s salary between medical and non-medical services performed by Employee A. Based on a representative sample of insurance and Medicare billing records, as well as time reports that Employee A submits to ATEO 1, ATEO 1 determines that Employee A spends 50 percent of her work hours providing patient care and 50 percent of her work hours performing administrative and management services. ATEO 1 allocates 50 percent of Employee A’s remuneration to medical services.

(2) *Conclusion.* ATEO 1’s allocation of Employee A’s salary is a reasonable, good faith allocation. Accordingly, only the 50 percent portion of Employee A’s remuneration allocated to the non-medical services is remuneration for purposes of paragraph (a) of this section.

(b) *Source of payment.* For purposes of this section, the determination of the source of a payment of remuneration may involve the application of one or both of two separate rules described in this paragraph (b). Paragraph (b)(1) of this section addresses payments by a third party for services performed as an employee of a separate employer entity, while paragraph (b)(2) of this section addresses the application of section 4960(c)(4)(A) to treat certain remuneration paid by a related organization (after application of paragraph

(b)(1) of this section, if applicable) as paid by the ATEO.

(1) *Remuneration paid by a third party for employment by an employer.* Remuneration paid (or a grant of a legally binding right to nonvested remuneration) by a third-party payor (whether a related organization, payroll agent, agent designated under section 3504, certified professional employer organization under section 7705, or other entity) during an applicable year for services performed as an employee of an employer is remuneration paid (or payable) by the employer, except as otherwise provided in §53.4960-1(d)(2)(ii) and (iii).

(2) *Remuneration paid by a related organization for employment by the related organization.* Pursuant to section 4960(c)(4)(A), remuneration paid (or a grant of a legally binding right to nonvested remuneration) by a related organization to an ATEO’s employee during an applicable year for services performed as an employee of the related organization is treated as remuneration paid (or payable) by the ATEO, except as otherwise provided in §53.4960-1(d)(2)(ii) and (iii).

(c) *Applicable year in which remuneration is treated as paid*—(1) *In general.* Remuneration that is a regular wage within the meaning of §31.3402(g)-1(a)(1)(ii) is treated as paid on the date it is actually or constructively paid and all other remuneration is treated as paid on the first date on which the remuneration is vested.

(2) *Vested remuneration.* Remuneration is *vested* if it is not subject to a substantial risk of forfeiture within the meaning of section 457(f)(3)(B) (regardless of whether the arrangement under which the remuneration is to be paid is deferred compensation described in section 457(f) or 409A). In general, an amount is subject to a substantial risk of forfeiture if entitlement to the amount is conditioned on the future performance of substantial services or upon the occurrence of a condition that is related to a purpose of the remuneration if the possibility of forfeiture is substantial. Except as provided in paragraph (c)(1) of this section, remuneration that is never subject to a substantial risk of forfeiture is considered paid on the first date the service provider has a legally binding right to the payment. For purposes of this section, a *plan* means a plan within

the meaning of §1.409A-1(c), an *account balance plan* means an account balance plan within the meaning of §1.409A-1(c)(2)(i)(A), and a *nonaccount balance plan* means a nonaccount balance plan within the meaning of §1.409A-1(c)(2)(i)(C). Net earnings on previously paid remuneration (described in paragraph (d)(2) of this section) that are not subject to a substantial risk of forfeiture are vested (and, thus, treated as paid) at the earlier of the date actually or constructively paid to the employee or the close of the applicable year in which they accrue. For example, the present value of a principal amount accrued to an employee's account under an account balance plan (under which the earnings and losses attributed to the account are based solely on a predetermined actual investment as determined under §31.3121(v)(2)-1(d)(2)(i)(B) or a reasonable market interest rate) is treated as paid on the date vested, but the present value of any net earnings subsequently accrued on that amount (the increase in value due to the predetermined actual investment or a reasonable market interest rate) is treated as paid at the close of the applicable year in which they accrue. Similarly, while the present value of an amount accrued under a nonaccount balance (including earnings that accrued while the amount was nonvested) is treated as paid on the date it is first vested, the present value of the net earnings on that amount (the increase in the present value) is treated as paid at the close of the applicable year in which they accrue.

(3) *Change in related status during the year.* If a taxpayer becomes or ceases to be a related organization with respect to an ATEO during an applicable year, then only the remuneration paid by the taxpayer to an employee with respect to services performed as an employee of the related organization during the portion of the applicable year during which the employer is a related organization is treated as paid by the ATEO. If an amount is treated as paid due to vesting in the year the taxpayer becomes or ceases to be a related organization with respect to the ATEO, then the amount is treated as paid by the ATEO only if the amount becomes vested during the portion of the applicable year that the taxpayer is a related organization with respect to the ATEO.

(d) *Amount of remuneration treated as paid—(1) In general.* For each applicable year, the amount of remuneration treated as paid by the employer to a covered employee is the sum of regular wages within the meaning of §31.3402(g)-1(a)(1)(ii) actually or constructively paid during the applicable year and the present value (as determined under paragraph (e) of this section) of all other remuneration that vested during the applicable year. The amount of remuneration that vests during an applicable year is determined on an employer-by-employer basis with respect to each covered employee.

(2) *Earnings and losses on previously paid remuneration—(i) In general.* The amount of net earnings or losses on previously paid remuneration paid by an employer is determined on an employee-by-employee basis, such that amounts accrued with regard to one employee do not affect amounts accrued with regard to a different employee. Similarly, losses accrued on previously paid remuneration from one employer do not offset earnings accrued on previously paid remuneration from another employer. The amount of net earnings or losses on previously paid remuneration paid by the employer is determined on a net aggregate basis for all plans maintained by the employer in which the employee participates for each applicable year. For example, losses under an account balance plan may offset earnings under a nonaccount balance plan for the same applicable year maintained by the same employer for the same employee.

(ii) *Previously paid remuneration—(A) New covered employee.* For an individual who was not a covered employee for any prior applicable year, *previously paid remuneration* means, for the applicable year for which the individual becomes a covered employee, the present value of vested remuneration that was not actually or constructively paid or otherwise includible in the employee's gross income before the start of the applicable year plus any remuneration that vested during the applicable year but that is not actually or constructively paid or otherwise includible in the employee's gross income before the close of the applicable year.

(B) *Existing covered employee.* For an individual who was a covered employee for any prior applicable year, *previously*

paid remuneration means, for each applicable year, the amount of remuneration that the employer treated as paid in the applicable year or for a prior applicable year but that is not actually or constructively paid or otherwise includible in the employee's gross income before the close of the applicable year. Actual or constructive payment or another event causing an amount of previously paid remuneration to be includible in the employee's gross income thus reduces the amount of previously paid remuneration.

(iii) *Earnings.* *Earnings* means any increase in the vested present value of previously paid remuneration as of the close of the applicable year, regardless of whether the plan denominates the increase as earnings. For example, an increase in the vested account balance of a nonqualified deferred compensation plan based solely on the investment return of a predetermined actual investment (and disregarding any additional contributions) constitutes earnings. Similarly, an increase in the vested present value of a benefit under a nonqualified nonaccount balance plan due solely to the passage of time (and disregarding any additional benefit accruals) constitutes earnings. However, an increase in an account balance of a nonqualified deferred compensation plan due to a salary reduction contribution or an employer contribution does not constitute earnings (and therefore may not be offset with losses). Likewise, an increase in the benefit under a nonaccount balance plan due to an additional year of service or an increase in compensation that is reflected in a benefit formula does not constitute earnings.

(iv) *Losses.* *Losses* means any decrease in the vested present value of previously paid remuneration as of the close of the applicable year, regardless of whether the plan denominates that decrease as losses.

(v) *Net earnings.* *Net earnings* means, for each applicable year, the amount (if any) by which the earnings accrued for the applicable year on previously paid remuneration exceeds the sum of the losses accrued on previously paid remuneration for the applicable year and any net losses carried forward from a previous taxable year.

(vi) *Net losses.* *Net losses* means, for each applicable year, the amount (if any) by which the sum of the losses accrued

on previously paid remuneration for the applicable year and any net losses carried forward from a previous taxable year exceed the earnings accrued for the applicable year on previously paid remuneration. Losses may only be used to offset earnings and thus do not reduce the remuneration treated as paid for an applicable year except to the extent of the earnings accrued for that applicable year. However, with regard to a covered employee, an employer may carry net losses forward to the next applicable year and offset vested earnings for purposes of determining net earnings or losses for that subsequent applicable year. For example, if a covered employee who participates in a nonaccount balance plan and an account balance plan vests in an amount of earnings under the nonaccount balance plan and has losses under the account balance plan that exceed the vested earnings treated as remuneration under the nonaccount balance plan, those excess losses are carried forward to the next applicable year and offset vested earnings for purposes of determining net earnings or losses for that applicable year. If, for the next applicable year, there are not sufficient earnings to offset the entire amount of losses carried forward from the previous year (and any additional losses), the offset process repeats for each subsequent applicable year until there are sufficient earnings for the applicable year to offset any remaining losses carried forward.

(3) *Remuneration paid for a taxable year before the employee becomes a covered employee*—(i) *In general.* In accordance with the payment timing rules of paragraph (c) of this section, any remuneration that is vested but is not actually or constructively paid or otherwise includible in an employee's gross income as of the close of the applicable year for the taxable year immediately preceding the taxable year in which the employee first becomes a covered employee of an ATEO is treated as previously paid remuneration for the taxable year in which the employee first becomes a covered employee. Net losses on this previously paid remuneration from any preceding applicable year do not carry forward to subsequent applicable years. However, net earnings and losses that vest on such previously paid remuneration in subsequent applicable

years are treated as remuneration paid for a taxable year for which the employee is a covered employee.

(ii) *Examples.* The following examples illustrate the rules of this paragraph (d)(3). For purposes of these examples, assume any organization described as “ATEO” is an ATEO.

(A) *Example 1 (Earnings on pre-covered employee remuneration)*—(1) *Facts.* ATEO 1 uses a taxable year beginning July 1 and ending June 30. Employee A becomes a covered employee of ATEO 1 for the taxable year beginning July 1, 2023, and ending June 30, 2024. During the 2022 applicable year, Employee A vests in \$1 million of nonqualified deferred compensation. As of December 31, 2022, the present value of the amount deferred under the plan is \$1.1 million. During the 2023 applicable year, ATEO 1 pays Employee A \$1 million in regular wages. The present value as of December 31, 2023, of Employee A's nonqualified deferred compensation is \$1.3 million.

(2) *Conclusion (Taxable year beginning July 1, 2022, and ending June 30, 2023).* ATEO 1 pays Employee A \$1.1 million of remuneration in the 2022 applicable year. This is comprised of \$1 million of vested nonqualified deferred compensation, and \$100,000 of earnings, all of which is treated as paid for the taxable year beginning July 1, 2022, and ending June 30, 2023.

(3) *Conclusion (Taxable year beginning July 1, 2023, and ending June 30, 2024).* ATEO 1 pays Employee A \$1.2 million of remuneration in the 2023 applicable year. This is comprised of \$1 million regular wages and \$200,000 of earnings (\$1.3 million present value as of December 31, 2023, minus \$1.1 million previously paid remuneration as of December 31, 2022).

(B) *Example 2 (Losses on pre-covered employee remuneration)*—(1) *Facts.* Assume the same facts as in paragraph (d)(3)(ii)(A) of this section (Example 1), except that the present value of the nonqualified deferred compensation as of December 31, 2022, is \$900,000.

(2) *Conclusion (Taxable year beginning July 1, 2022, and ending June 30, 2023).* ATEO 1 pays Employee A \$1 million of remuneration in the 2022 applicable year. This is comprised of \$1 million of vested nonqualified deferred compensation. The present value of all vested deferred compensation as of December 31 of the 2022 applicable year (\$900,000) is treated as previously paid remuneration for the next applicable year (as Employee A is a covered employee for the next taxable year). The \$100,000 of losses accrued while Employee A was not a covered employee do not carry forward to the next applicable year.

(3) *Conclusion (Taxable year beginning July 1, 2023, and ending June 30, 2024).* ATEO 1 pays Employee A \$1.4 million of remuneration in the 2023 applicable year. This is comprised of \$1 million cash and \$400,000 of earnings (\$1.3 million present value as of December 31, 2023, minus \$900,000 previously paid remuneration).

(e) *Calculation of present value*—(1) *In general.* The employer must determine

present value using reasonable actuarial assumptions regarding the amount, time, and probability that a payment will be made. For this purpose, a discount for the probability that an employee will die before commencement of benefit payments is permitted, but only to the extent that benefits will be forfeited upon death. The present value may not be discounted for the probability that payments will not be made (or will be reduced) because of the unfunded status of the plan; the risk associated with any deemed or actual investment of amounts deferred under the plan; the risk that the employer, the trustee, or another party will be unwilling or unable to pay; the possibility of future plan amendments; the possibility of a future change in the law; or similar risks or contingencies. The present value of the right to future payments as of the vesting date includes any earnings that have accrued as of the vesting date that are not previously paid remuneration.

(2) *Treatment of future payment amount as present value for certain amounts.* For purposes of determining the present value of remuneration that is scheduled to be actually or constructively paid within 90 days of vesting, the employer may treat the future amount that is to be paid as the present value at vesting.

(f) *Examples.* The following examples illustrate the rules of this section. For purposes of these examples, assume any entity referred to as “ATEO” is an ATEO, any entity referred to as “CORP” is not an ATEO, and all taxpayers use the calendar year as their taxable year.

(1) *Example 1 (Account balance plan)*—(i) *Facts.* Employee A is a covered employee of ATEO 1. Employee A participates in a nonqualified deferred compensation plan (the NQDC plan) in which the account balance is adjusted based on the investment returns on predetermined actual investments. On January 1, 2022, ATEO 1 credits \$100,000 to Employee A's account under the plan, subject to the requirement that Employee A remain employed through June 30, 2024. On June 30, 2024, the vested account balance is \$110,000. Due to earnings or losses on the account balance, the closing account balance on each of the following dates is: \$115,000 on December 31, 2024, \$120,000 on December 31, 2025, \$100,000 on December 31, 2026, and \$110,000 on December 31, 2027. During 2028, Employee A defers an additional \$10,000 under the plan, all of which is vested at the time of deferral. On December 31, 2028, the closing account balance is \$125,000. In 2029, ATEO 1 pays \$10,000 to Employee A under the plan. On December 31, 2029, the closing account balance is \$135,000 due to earnings on the account balance.

(ii) *Conclusion (2022 and 2023 applicable years—nonvested amounts)*. For 2022 and 2023, ATEO 1 is not treated as paying Employee A any remuneration attributable to Employee A's participation in the NQDC plan because the amount deferred under the plan remains subject to a substantial risk of forfeiture within the meaning of section 457(f)(3)(B).

(iii) *Conclusion (2024 applicable year—amounts in year of vesting)*. For 2024, ATEO 1 is treated as paying Employee A \$115,000 of remuneration attributable to Employee A's participation in the NQDC plan, including \$110,000 of remuneration on June 30, 2024, when the amount becomes vested, and an additional \$5,000 of remuneration on December 31, 2024, which is earnings on the previously paid remuneration (\$110,000).

(iv) *Conclusion (2025 applicable year—earnings)*. For 2025, ATEO 1 is treated as paying Employee A \$5,000 of remuneration attributable to Employee A's participation in the NQDC plan, which is the additional earnings on the previously paid remuneration (\$115,000) as of December 31, 2025.

(v) *Conclusion (2026 applicable year—losses)*. For 2026, ATEO 1 is not treated as paying Employee A any remuneration attributable to Employee A's participation in the NQDC plan because the present value of the previously paid remuneration (\$120,000) decreased to \$100,000 as of December 31, 2026. The \$20,000 loss for 2026 does not reduce any amount previously treated as remuneration but is available for carryover to subsequent taxable years to offset earnings.

(vi) *Conclusion (2027 applicable year—recovery of losses)*. For 2027, ATEO 1 is not treated as paying Employee A any remuneration attributable to Employee A's participation in the NQDC plan because the present value of the previously paid remuneration (\$120,000) was \$110,000 as of December 31, 2027. Due to increases on the account balance, ATEO 1 recovers \$10,000 of the \$20,000 of losses carried over from 2026. The net losses as of December 31, 2027, are \$10,000, and none of the \$10,000 in earnings during 2027 is treated as remuneration paid in 2027.

(vii) *Conclusion (2028 applicable year—no recovery of losses against additional deferrals of compensation)*. For 2028, ATEO 1 is treated as paying Employee A \$10,000 of remuneration attributable to Employee A's participation in the NQDC plan. The additional \$10,000 deferral is vested and thus is treated as remuneration paid on the date credited to Employee A's account. This credit increases the amount of previously paid remuneration from \$120,000 to \$130,000. Additionally, due to earnings, ATEO 1 recovers \$5,000 of the \$10,000 loss carried over from 2027, none of which was remuneration paid for 2026, so that as of December 31, 2028, the net loss available for carryover to 2029 is \$5,000.

(viii) *Conclusion (2029 applicable year—distributions, recovery of remainder of losses through earnings and additional earnings)*. For 2029, ATEO 1 is treated as paying Employee A \$15,000 of remuneration attributable to Employee A's participation in the NQDC plan. The \$10,000 payment reduces the amount of previously paid remuneration (from \$130,000 to \$120,000) and the account balance (from \$125,000 to \$115,000). The present value of

the vested account balance increases by \$20,000 (from \$115,000 to \$135,000) as of December 31, 2029. Therefore, due to earnings, ATEO 1 recovers the remaining \$5,000 loss carried over from 2028 (the difference between the \$120,000 previously paid remuneration before earnings and the \$115,000 account balance before earnings) and is treated as paying Employee A an additional \$15,000 of remuneration as earnings (the difference between the \$135,000 account balance after earnings and the \$120,000 previously paid remuneration after loss recovery).

(2) *Example 2 (Nonaccount balance plan with earnings)*—(i) *Facts*. ATEO 2 and CORP 2 are related organizations. Employee B is a covered employee of ATEO 2 and is also employed by CORP 2. On January 1, 2022, CORP 2 and Employee B enter into an agreement under which CORP 2 will pay Employee B \$100,000 on December 31, 2025, if B remains employed by CORP 2 through January 1, 2024. Employee B remains employed by CORP 2 through January 1, 2024. On January 1, 2024, the present value based on reasonable actuarial assumptions of the \$100,000 to be paid on December 31, 2025, is \$75,000. On December 31, 2024, the present value of the \$100,000 future payment increases to \$85,000 due solely to the passage of time. On December 31, 2025, CORP 2 pays Employee B \$100,000.

(ii) *Conclusion (2022 and 2023 applicable years—nonvested amounts)*. For 2022 and 2023, CORP 2 is not treated as paying Employee B any remuneration attributable to the agreement because the amount deferred under the agreement remains subject to a substantial risk of forfeiture within the meaning of section 457(f)(3)(B).

(iii) *Conclusion (2024 applicable year—amounts in year of vesting)*. For 2024, CORP 2 is treated as paying Employee B \$75,000 of remuneration attributable to the agreement on January 1, 2024, which is the present value on that date of the \$100,000 payable on December 31, 2025. In addition, CORP 2 is treated as paying Employee B \$10,000 of remuneration attributable to the agreement on December 31, 2024, which is earnings based on the increase in the present value of the previously paid remuneration (from \$75,000 to \$85,000) as of December 31, 2024.

(iv) *Conclusion (2025 applicable year—earnings and distribution of previously paid remuneration)*. For 2025, CORP 2 is treated as paying Employee B \$15,000 in remuneration attributable to the agreement on December 31, 2025, which is earnings based on the increase in the present value of the previously paid remuneration (from \$85,000 to \$100,000) as of December 31, 2025. In addition, the \$100,000 payment is treated as reducing the amount of previously paid remuneration (\$100,000) to zero.

(3) *Example 3 (Treatment of amount payable as present value at vesting)*—(i) *Facts*. Employee C is a covered employee of ATEO 3. Under an agreement between ATEO 3 and Employee C, ATEO 3 agrees to pay Employee C \$100,000 two months after the date Employee C meets a specified performance goal that is a substantial risk of forfeiture within the meaning of section 457(f)(3)(B). Employee C meets the performance goal on November 30, 2022, and ATEO 3 pays Employee C \$100,000 on January 31, 2023. In accordance with §53.4960-2(e)(2), because the payment is to be made within 90 days of vesting,

ATEO 3 elects to treat the full payment amount as the amount of remuneration paid at vesting.

(ii) *Conclusion (2022 applicable year—election to treat amount payable within 90 days as paid at vesting)*. For taxable year 2022, ATEO 3 is treated as paying Employee C \$100,000 of remuneration attributable to the agreement. Employee C vests in the \$100,000 payment in 2022 upon meeting the performance goal. Under the general rule, ATEO 3 would be treated as paying for the taxable year 2022 the present value as of November 30, 2022, of \$100,000 payable on January 31, 2023 (two months after the date of vesting), with adjustments to the present value as of the end of the year. However, because ATEO 3 elected to treat the full \$100,000 amount payable within 90 days of vesting as the remuneration paid, the \$100,000 payable to Employee C in 2023 is treated as remuneration paid in 2022 (and no additional amount related to the \$100,000 paid on January 31, 2023, is treated as remuneration paid in 2023).

(4) *Example 4 (Aggregation of remuneration from related organizations)*—(i) *Facts*. Employee D is a covered employee of ATEO 4 and also an employee of CORP 4 and CORP 5. ATEO 4, CORP 4, and CORP 5 are related organizations. ATEO 4, CORP 4, and CORP 5 each pay Employee D \$200,000 of salary during 2022 and 2023. On January 1, 2022, ATEO 4 promises to pay Employee D \$120,000 on December 31, 2023, under a nonaccount balance plan, the right to which is vested and the present value of which is \$100,000 on January 1, 2022. On January 1, 2022, CORP 4 and CORP 5 each contribute \$100,000 on Employee D's behalf to account balance plans of CORP 4 and CORP 5, respectively, under which all amounts deferred are vested. On December 31, 2022, the present value of the amounts deferred under the ATEO 4 plan is \$110,000, the present value of the amounts deferred under the CORP 4 plan is \$120,000, and the present value of the amounts deferred under the CORP 5 plan maintained is \$90,000. On December 31, 2023, the present value of the amounts deferred under the ATEO 4 plan is \$120,000, the present value of the amounts deferred under the CORP 4 plan is \$130,000, and the present value of the amounts deferred under the CORP 5 plan is \$110,000.

(ii) *Conclusion (2022 applicable year)*. For 2022, before aggregation of remuneration paid by related organizations, ATEO 4 is treated as paying Employee D \$310,000 of remuneration (\$200,000 salary + \$100,000 upon vesting of deferred amounts + \$10,000 net earnings on vested deferred amounts). CORP 4 is treated as paying Employee D \$320,000 of remuneration (\$200,000 salary + \$100,000 upon vesting of deferred amounts + \$20,000 net earnings on vested deferred amounts). CORP 5 is treated as paying Employee D \$300,000 of remuneration (\$200,000 salary + \$100,000 upon vesting of deferred amounts) and has \$10,000 of net losses on vested deferred amounts, which are carried forward to 2023. Thus, ATEO 4 is treated as paying \$930,000 of remuneration to Employee D for the applicable year.

(iii) *Conclusion (2023 applicable year)*. For 2023, before aggregation of remuneration paid by related organizations, ATEO 4 is treated as paying Employee D \$210,000 of remuneration (\$200,000 salary + \$10,000 earnings on previously paid re-

muneration). CORP 4 is treated as paying Employee D \$210,000 of remuneration (\$200,000 salary + \$10,000 net earnings on previously paid remuneration). CORP 5 is treated as paying Employee D \$210,000 of remuneration (\$200,000 salary + \$10,000 net earnings on previously paid remuneration after taking into account the loss carryforward). Thus, ATEO 4 is treated as paying \$630,000 of remuneration to Employee D for the applicable year.

(5) *Example 5 (Treatment of regular wages for a pay period spanning applicable years)*—(i) *Facts*. ATEO 5 pays its employees' salaries in accordance with a two-week payroll period that begins Sunday of the first week and ends Saturday of the second week. Payment occurs the Friday following the end of the payroll period. The last payroll period of 2023 ends on December 31, 2023. For the last payroll period, Employee E earns \$8,000 of salary. In addition, ATEO 5 awards Employee E a \$10,000 bonus that vests on December 31, 2023. ATEO 5 pays Employee E \$18,000 on Friday, January 5, 2024, reflecting Employee E's salary for the last payroll period of 2023 and the bonus, the right to which vested on December 31, 2023.

(ii) *Conclusion (Regular wages)*. The \$8,000 of salary is regular wages within the meaning of §31.3402(g)-1(a)(1)(ii) because it is an amount paid at a periodic rate for the current payroll period. Thus, \$8,000 is treated as remuneration paid on January 5, 2024 (when it is actually or constructively paid), and, therefore, is treated as remuneration paid in ATEO 5's 2024 applicable year.

(iii) *Conclusion (Amounts other than regular wages)*. The \$10,000 bonus is not regular wages within the meaning of §31.3402(g)-1(a)(1)(ii) because it is not an amount paid at a periodic rate for the current payroll period. Thus, \$10,000 is treated as remuneration paid on December 31, 2023 (when it is vested) and, therefore, is treated as remuneration paid in ATEO 5's 2023 applicable year.

§53.4960-3 Determination of whether there is a parachute payment.

(a) *Parachute payment*—(1) *In general*. Except as otherwise provided in paragraph (a)(2) of this section (relating to payments excluded from the definition of a parachute payment), *parachute payment* means any payment in the nature of compensation made by an ATEO (or a predecessor of the ATEO) or a related organization to (or for the benefit of) a covered employee if the payment is contingent on the employee's separation from employment with the employer, and the aggregate present value of the payments in the nature of compensation to (or for the benefit of) the individual that are contingent on the separation equals or exceeds an amount equal to 3-times the base amount.

(2) *Exclusions*. The following payments are not parachute payments:

(i) *Certain qualified plans*. A payment that is a contribution to or a distribution from a plan described in section 401(a) that includes a trust exempt from tax under section 501(a), an annuity plan described in section 403(a), a simplified employee pension (as defined in section 408(k)), or a simple retirement account described in section 408(p);

(ii) *Certain annuity contracts*. A payment made under or to an annuity contract described in section 403(b) or a plan described in section 457(b);

(iii) *Compensation for medical services*. A payment made to a licensed medical professional for the performance of medical services performed by such professional; and

(iv) *Payments to non-HCEs*. A payment made to an individual who is not a highly compensated employee (HCE) as defined in paragraph (a)(3) of this section.

(3) *Determination of HCEs for purposes of the exclusion from parachute payments*. For purposes of this section, *highly compensated employee* or *HCE* means, with regard to an ATEO that maintains a qualified retirement plan or other employee benefit plan described in §1.414(q)-1T, Q/A-1, any person who is a highly compensated employee within the meaning of section 414(q) and, with regard to an ATEO that does not maintain such a plan, any person who would be a highly compensated employee within the meaning of section 414(q) if the ATEO did maintain such a plan. For purposes of determining the group of highly compensated employees for a determination year, consistent with §1.414(q)-1T, Q/A-14(a)(1), the determination year calculation is made on the basis of the applicable plan year under §1.414(q)-1T, Q/A-14(a)(2) of the plan or other entity for which a determination is made, and the look-back year calculation is made on the basis of the 12-month period immediately preceding that year. For an ATEO that does not maintain a plan described in §1.414(q)-1T, Q/A-1, the rules are applied by analogy, substituting the calendar year for the plan year. Thus, for example, in 2022, an ATEO that does not maintain such a plan must use its employees' 2021 annual compensation (as defined in §1.414(q)-1T, Q/A-13, including any of the safe harbor definitions if applied consistently to all employees) to

determine which employees are HCEs for 2022, if any, for purposes of section 4960. If an employee is an HCE at the time of separation from employment, then for purposes of section 4960 any parachute payment that is contingent on the separation from employment (as defined in paragraph (d) of this section) is treated as paid to an HCE so that the exception from the term parachute payment under paragraph (a)(2)(iv) of this section does not apply, even if the payment occurs during one or more later taxable years (that is, taxable years after the taxable year during which the employee separated from employment).

(b) *Payment in the nature of compensation*—(1) *In general*. Any payment—in whatever form—is a payment in the nature of compensation if the payment arises out of an employment relationship, including holding oneself out as available to perform services and refraining from performing services. Thus, for example, a payment made under a covenant not to compete or a similar arrangement is a payment in the nature of compensation. A payment in the nature of compensation includes (but is not limited to) wages and salary, bonuses, severance pay, fringe benefits, life insurance, pension benefits, and other deferred compensation (including any amount characterized by the parties as interest or earnings thereon). A payment in the nature of compensation also includes cash when paid, the value of the right to receive cash, the value of accelerated vesting, or a transfer of property. The vesting of an option, stock appreciation right, or similar form of compensation as a result of a covered employee's separation from employment is a payment in the nature of compensation. However, a payment in the nature of compensation does not include attorney's fees or court costs paid or incurred in connection with the payment of any parachute payment or a reasonable rate of interest accrued on any amount during the period the parties contest whether a parachute payment will be made.

(2) *Consideration paid by covered employee*. Any payment in the nature of compensation is reduced by the amount of any money or the fair market value of any property (owned by the covered employee without restriction) that is (or will

be) transferred by the covered employee in exchange for the payment.

(c) *When payment is considered to be made*—(1) *In general.* A payment in the nature of compensation is considered made in the taxable year in which it is includible in the covered employee's gross income or, in the case of fringe benefits and other benefits that are excludable from income, in the taxable year the benefits are received. In the case of taxable non-cash fringe benefits provided in a calendar year, payment is considered made on the date or dates the employer chooses, but no later than December 31 of the calendar year in which the benefits are provided, except that when the fringe benefit is the transfer of personal property (either tangible or intangible) of a kind normally held for investment or the transfer of real property, payment is considered made on the actual date of transfer. If the fringe benefit is neither a transfer of personal property nor a transfer of real property, the employer may, in its discretion, treat the value of the benefit actually provided during the last two months of the calendar year as paid during the subsequent calendar year. However, an employer that treats the value of a benefit paid during the last two months of a calendar year as paid during the subsequent calendar year under this rule must treat the value of that fringe benefit as paid during the subsequent calendar year with respect to all employees who receive it.

(2) *Transfers of section 83 property.* A transfer of property in connection with the performance of services that is subject to section 83 is considered a payment made in the taxable year in which the property is transferred or would be includible in the gross income of the covered employee under section 83, disregarding any election made by the employee under section 83(b) or (i). Thus, in general, such a payment is considered made at the later of the date the property is transferred (as defined in §1.83-3(a)) to the covered employee or the date the property becomes substantially vested (as defined in §1.83-3(b) and (j)). The amount of the payment is the compensation as determined under section 83, disregarding any amount includible in income pursuant to an election made by an employee under section 83(b).

(3) *Stock options.* An option (including an option to which section 421 applies) is treated as property that is transferred when the option becomes vested (regardless of whether the option has a readily ascertainable fair market value as defined in §1.83-7(b)). For purposes of determining the timing and amount of any payment related to the option, the principles of §1.280G-1, Q/A-13 and any method prescribed by the Commissioner in published guidance of general applicability under §601.601(d)(2) apply.

(d) *Payment contingent on an employee's separation from employment*—(1) *In general.* A payment is contingent on an employee's separation from employment if the facts and circumstances indicate that the employer would not make the payment in the absence of the employee's involuntary separation from employment. A payment generally would be made in the absence of the employee's involuntary separation from employment if it is substantially certain at the time of the involuntary separation from employment that the payment would be made whether or not the involuntary separation occurred. A payment the right to which is not subject to a substantial risk of forfeiture within the meaning of section 457(f)(3)(B) at the time of an involuntary separation from employment generally is a payment that would have been made in the absence of an involuntary separation from employment (and is therefore not contingent on a separation from employment), except that the increased value of an accelerated payment of a vested amount described in paragraph (f)(3) of this section resulting from an involuntary separation from employment is not treated as a payment that would have been made in the absence of an involuntary separation from employment. A payment the right to which is no longer subject to a substantial risk of forfeiture within the meaning of section 457(f)(3)(B) as a result of an involuntary separation from employment, including a payment the vesting of which is accelerated due to the separation from employment as described in paragraph (f)(3) of this section, is not treated as a payment that would have been made in the absence of an involuntary separation from employment (and thus is contingent on a separation from employment). A payment

does not fail to be contingent on a separation from employment merely because the payment is conditioned upon the execution of a release of claims, noncompetition or nondisclosure provisions, or other similar requirements. See paragraph (d)(3) of this section for the treatment of a payment made pursuant to a covenant not to compete. If, after an involuntary separation from employment, the former employee continues to provide certain services as a nonemployee, payments for services rendered as a nonemployee are not payments that are contingent on a separation from employment to the extent those payments are reasonable and are not made on account of the involuntary separation from employment. Whether services are performed as an employee or nonemployee depends upon all the facts and circumstances. See §53.4960-1(e). For rules on determining whether payments are reasonable compensation for services, the rules of §1.280G-1, Q/A-40 through Q/A-42 (excluding Q/A-40(b) and Q/A-42(b)), and Q/A-44 are applied by analogy (substituting involuntary separation from employment for change in ownership or control).

(2) *Employment agreements*—(i) *In general.* If a covered employee involuntarily separates from employment before the end of a contract term and is paid damages for breach of contract pursuant to an employment agreement, the payment of damages is treated as a payment that is contingent on a separation from employment. An *employment agreement* is an agreement between an employee and employer that describes, among other things, the amount of compensation or remuneration payable to the employee for services performed during the term of the agreement.

(ii) *Example.* The following example illustrates the rules of this paragraph (d)(2). For purposes of this example, assume any entity referred to as "ATEO" is an ATEO.

(A) *Example—(1) Facts.* Employee A, a covered employee, has a 3-year employment agreement with ATEO 1. Under the agreement, Employee A will receive a salary of \$200,000 for the first year and, for each succeeding year, an annual salary that is \$100,000 more than the previous year. The agreement provides that, in the event of A's involuntary separation from employment without cause, Employee A will receive the remaining salary due under the agreement. At the beginning of the second year of

the agreement, ATEO 1 involuntarily terminates Employee A's employment without cause and pays Employee A \$700,000 representing the remaining salary due under the employment agreement (\$300,000 for the second year of the agreement plus \$400,000 for the third year of the agreement).

(2) *Conclusion.* The \$700,000 payment is treated as a payment that is contingent on a separation from employment.

(3) *Noncompetition agreements.* A payment under an agreement requiring a covered employee to refrain from performing services (for example, a covenant not to compete) is a payment that is contingent on a separation from employment if the payment would not have been made in the absence of an involuntary separation from employment. For example, a payment contingent on compliance in whole or in part with a covenant not to compete negotiated as part of a severance arrangement arising from an involuntary separation from employment is contingent on a separation from employment. Similarly, one or more payments contingent on compliance in whole or in part with a covenant not to compete not negotiated as part of a severance arrangement arising from an involuntary separation from employment but that provides for a payment specific to an involuntary separation from employment (and not voluntary separation from employment) is contingent on a separation from employment. Payments made under an agreement requiring a covered employee to refrain from performing services that are contingent on separation from employment are not treated as paid in exchange for the performance of services and are not excluded from parachute payments.

(4) *Payment of amounts previously included in income or excess remuneration.* Actual or constructive payment of an amount that was previously included in gross income of the employee is not a payment contingent on a separation from employment. For example, payment of an amount included in income under section 457(f)(1)(A) due to the lapsing of a substantial risk of forfeiture on a date before the separation from employment generally is not a payment that is contingent on a separation from employment, even if the amount is paid in cash or otherwise to the employee because of the separation from employment. In addition, actual or constructive receipt of an amount treated as excess remuneration under §53.4960-4(b)(1) is not a payment that is contingent on a separation from employment (and thus is not a parachute payment), even if the amount is paid to the employee because of the separation from employment.

(5) *Window programs.* A payment under a window program is contingent on a separation from employment. A *window program* is a program established by an employer in connection with an impending separation from employment to provide separation pay if the program is made available by the employer for a limited period of time (no longer than 12 months) to employees who separate from employment during that period or to employees who separate from service during that period under specified circumstances. A payment made under a window program is treated as a payment that is contingent on an employee's separation from employment notwithstanding that the employee may not have had an involuntary separation from employment.

(6) *Anti-abuse provision.* Notwithstanding paragraphs (d)(1) through (5) of this section, if the facts and circumstances demonstrate that either the vesting or the payment of an amount (whether before or after an employee's involuntary separation from employment) would not have occurred but for the involuntary nature of the separation from employment, the payment of the amount is contingent on a separation from employment. For example, an employer's exercise of discretion to accelerate vesting of an amount shortly before an involuntary separation from employment may indicate that the acceleration of vesting was due to the involuntary nature of the separation from employment and was therefore contingent on the employee's separation from employment. Similarly, payment of an amount in excess of an amount otherwise payable (for example, increased salary), shortly before or after an involuntary separation from employment, may indicate that the amount was paid because the separation was involuntary and was therefore contingent on the employee's separation from employment. If an ATEO becomes a predecessor as a result of a reorganization or other transaction described in §53.4960-1(h), any payment to an employee by a successor organization that is contingent on the employee's separation from employment with the predecessor ATEO is treated as paid by the predecessor ATEO.

(e) *Involuntary separation from employment—(1) In general.* *Involuntary separation from employment* means a separation from employment due to the independent exercise of the employer's unilateral authority to terminate the employee's services, other than due to the employee's implicit or explicit request, if the employee was willing and able to continue performing services as an employee. An involuntary separation from employment may include an employer's failure to renew a contract at the time the contract expires, provided that the employee was willing and able to execute a new contract providing terms and conditions substantially similar to those in the expiring contract and to continue providing services. The determination of whether a separation from employment is involuntary is based on all the facts and circumstances.

(2) *Separation from employment for good reason—(i) In general.* Notwithstanding paragraph (e)(1) of this section, an employee's voluntary separation from employment is treated as an involuntary separation from employment if the separation occurs under certain bona fide conditions (referred to herein as a separation from employment for good reason).

(ii) *Material negative change required.* A separation from employment for good reason is treated as an involuntary separation from employment if the relevant facts

and circumstances demonstrate that it was the result of unilateral employer action that caused a material negative change to the employee's relationship with the employer. Factors that may provide evidence of such a material negative change include a material reduction in the duties to be performed, a material negative change in the conditions under which the duties are to be performed, or a material reduction in the compensation to be received for performing such services.

(iii) *Deemed material negative change.* An involuntary separation from employment due to a material negative change is deemed to occur if the separation from employment occurs within 2 years following the initial existence of one or more of the following conditions arising without the consent of the employee:

(A) *Material diminution of compensation.* A material diminution in the employee's base compensation;

(B) *Material diminution of responsibility.* A material diminution in the employee's authority, duties, or responsibilities;

(C) *Material diminution of authority of supervisor.* A material diminution in the authority, duties, or responsibilities of the supervisor to whom the employee is required to report, including a requirement that an employee report to a corporate officer or employee instead of reporting directly to the board of directors (or similar governing body) of an organization;

(D) *Material diminution of budget.* A material diminution in the budget over which the employee retains authority;

(E) *Material change of location.* A material change in the geographic location at which the employee must perform services; or

(F) *Other material breach.* Any other action or inaction that constitutes a material breach by the employer of the agreement under which the employee provides services.

(3) *Separation from employment.* Except as otherwise provided in this paragraph, separation from employment has the same meaning as separation from service as defined in §1.409A-1(h). Pursuant to §1.409A-1(h), an employee generally separates from employment with the employer if the employee dies, retires, or otherwise has a termination of employment with the employer or experiences a

sufficient reduction in the level of services provided to the employer. For purposes of applying the rules regarding reductions in the level of services set forth in the definition of termination of employment in §1.409A-1(h)(1)(ii), the rules are modified for purposes of this paragraph such that an employer may not set the level of the anticipated reduction in future services that will give rise to a separation from employment, meaning that the default percentages set forth in §1.409A-1(h)(1)(ii) apply in all circumstances. Thus, an anticipated reduction of the level of service of less than 50 percent is not treated as a separation from employment, an anticipated reduction of more than 80 percent is treated as a separation from employment, and the treatment of an anticipated reduction between those two levels is determined based on the facts and circumstances. The measurement of the anticipated reduction of the level of service is based on the average level of service for the prior 36 months (or shorter period for an employee employed for less than 36 months). In addition, an employee's separation from employment is determined without regard to §1.409A-1(h)(2) and (5) (application to independent contractors), since, for purposes of this section, only an employee may have a separation from employment, and a change from bona fide employee status to bona fide independent contractor status is also a separation from employment. See §53.4960-2(a)(1) regarding the treatment of an employee who also serves as a director of a corporation (or in a substantially similar position). The definition of separation from employment also incorporates the rules under §1.409A-1(h)(1)(i) (addressing leaves of absence, including military leaves of absence), §1.409A-1(h)(4) (addressing asset purchase transactions), and §1.409A-1(h)(6) (addressing employees participating in collectively bargained plans covering multiple employers). The definition further incorporates the rules of §1.409A-1(h)(3), under which an employee separates from employment only if the employee has a separation from employment with the employer and all employers that would be considered a single employer under section 414(b) and (c), except that the "at least 80 percent" rule under section 414(b) and (c) is used, rather than replacing it with "at least 50 percent." However,

for purposes of determining whether there has been a separation from employment, a purported ongoing employment relationship between a covered employee and an ATEO or a related organization is disregarded if the facts and circumstances demonstrate that the purported employment relationship is not bona fide, or the primary purpose of the establishment or continuation of the relationship is avoidance of the application of section 4960.

(f) *Accelerated payment or accelerated vesting resulting from an involuntary separation from employment*—(1) *In general.* If a payment or the lapse of a substantial risk of forfeiture is accelerated as a result of an involuntary separation from employment, generally only the value due to the acceleration of payment or vesting is treated as contingent on a separation from employment, as described in paragraphs (f)(3) and (4) of this section, except as otherwise provided in this paragraph (f). For purposes of this paragraph (f), the terms *vested* and *substantial risk of forfeiture* have the same meaning as provided in §53.4960-2(c)(2).

(2) *Nonvested payments subject to a non-service vesting condition.* If (without regard to a separation from employment) vesting of a payment would depend on an event other than the performance of services, such as the attainment of a performance goal, and that vesting event does not occur prior to the employee's separation from employment and the payment vests due to the employee's involuntary separation from employment, the full amount of the payment is treated as contingent on the separation from employment.

(3) *Vested payments.* If an involuntary separation from employment accelerates actual or constructive payment of an amount that previously vested without regard to the separation, the portion of the payment, if any, that is contingent on the separation from employment is the amount by which the present value of the accelerated payment exceeds the present value of the payment absent the acceleration. The payment of an amount otherwise due upon a separation from employment (whether voluntary or involuntary) is not treated as an acceleration of the payment unless the payment timing was accelerated due to the involuntary nature of the separation

from employment. If the value of the payment absent the acceleration is not reasonably ascertainable, and the acceleration of the payment does not significantly increase the present value of the payment absent the acceleration, the present value of the payment absent the acceleration is the amount of the accelerated payment (so the amount contingent on the separation from employment is zero). If the present value of the payment absent the acceleration is not reasonably ascertainable but the acceleration significantly increases the present value of the payment, the future value of the payment contingent on the separation from employment is treated as equal to the amount of the accelerated payment. For purposes of this paragraph (f)(3), the acceleration of a payment by 90 days or less is not treated as significantly increasing the present value of the payment. For rules on determining present value, see paragraph (f)(6) and paragraphs (h), (i) and (j) of this section.

(4) *Nonvested payments subject to a service vesting condition*—(i) *In general.* If an involuntary separation from employment accelerates vesting of a payment, the portion of the payment that is contingent on separation from employment is the amount described in paragraph (f)(3) of this section (if any) plus the value of the lapse of the obligation to continue to perform services described in paragraph (f)(4)(ii) of this section (but the amount cannot exceed the amount of the accelerated payment, or, if the payment is not accelerated, the present value of the payment), to the extent that all of the following conditions are satisfied with respect to the payment:

(A) *Vesting trigger.* The payment vests as a result of an involuntary separation from employment;

(B) *Vesting condition.* Disregarding the involuntary separation from employment, the vesting of the payment was contingent only on the continued performance of services for the employer for a specified period of time; and

(C) *Services condition.* The payment is attributable, at least in part, to the performance of services before the date the payment is made or becomes certain to be made.

(ii) *Value of the lapse of the obligation to continue to perform services.* The value

of the lapse of the obligation to continue to perform services is one percent of the amount of the accelerated payment multiplied by the number of full months between the date that the employee's right to receive the payment is vested and the date that, absent the acceleration, the payment would have been vested. This paragraph (f)(4)(ii) applies to the accelerated vesting of a payment in the nature of compensation even if the time when the payment is made is not accelerated. In that case, the value of the lapse of the obligation to continue to perform services is one percent of the present value of the future payment multiplied by the number of full months between the date that the individual's right to receive the payment is vested and the date that, absent the acceleration, the payment would have been vested.

(iii) *Accelerated vesting of equity compensation.* For purposes of this paragraph (f)(4), the acceleration of the vesting of a stock option or stock appreciation right (or similar arrangement) or the lapse of a restriction on restricted stock or a restricted stock unit (or a similar arrangement) is considered to significantly increase the value of the payment.

(5) *Application to benefits under a nonqualified deferred compensation plan.* In the case of a payment of benefits under a nonqualified deferred compensation plan, paragraph (f)(3) of this section applies to the extent benefits under the plan are vested without regard to the involuntary separation from employment, but the payment of benefits is accelerated due to the involuntary separation from employment. Paragraph (f)(4) of this section applies to the extent benefits under the plan are subject to the conditions described in paragraph (f)(4)(i) of this section. For any other payment of benefits under a nonqualified deferred compensation plan (such as a contribution made due to the employee's involuntary separation from employment), the full amount of the payment is contingent on the employee's separation from employment.

(6) *Present value.* For purposes of this paragraph (f), the present value of a payment is determined based on the payment date absent the acceleration and the date on which the accelerated payment is scheduled to be made. The amount that is treated as contingent on the separation

from employment is the amount by which the present value of the accelerated payment exceeds the present value of the payment absent the acceleration.

(7) *Examples.* See §1.280G Q/A-24(f) for examples that may be applied by analogy to illustrate the rules of this paragraph (f).

(g) *Three-times-base-amount test for parachute payments—(1) In general.* To determine whether payments in the nature of compensation made to a covered employee that are contingent on the covered employee separating from employment with the ATEO are parachute payments, the aggregate present value of the payments must be compared to the individual's base amount. To do this, the aggregate present value of all payments in the nature of compensation that are made or to be made to (or for the benefit of) the same covered employee by an ATEO (or any predecessor of the ATEO) or related organization and that are contingent on the separation from employment must be determined. If this aggregate present value equals or exceeds the amount equal to 3-times the individual's base amount, the payments are parachute payments. If this aggregate present value is less than the amount equal to 3-times the individual's base amount, the payments are not parachute payments. See paragraphs (f)(6), (h), (i), and (j) of this section for rules on determining present value.

(2) *Examples.* The following examples illustrate the rules of this paragraph (g). For purposes of these examples, assume any entity referred to as "ATEO" is an ATEO.

(i) *Example 1 (Parachute payment)—(A) Facts.* Employee A is a covered employee and an HCE of ATEO 1. Employee A's base amount is \$200,000. Payments in the nature of compensation that are contingent on a separation from employment with ATEO 1 totaling \$800,000 are made to Employee A on the date of Employee A's separation from employment.

(B) *Conclusion.* The payments are parachute payments because they have an aggregate present value at the time of the separation from employment of \$800,000, which is at least equal to 3-times Employee A's base amount of \$200,000 ($3 \times \$200,000 = \$600,000$).

(ii) *Example 2 (No parachute payment)—(A) Facts.* Assume the same facts as in paragraph (g)(2)(i) of this section (Example 1), except that the payments contingent on Employee A's separation from employment total \$580,000.

(B) *Conclusion.* Because the aggregate present value of the payments (\$580,000) is not at least equal

to 3-times Employee A's base amount (\$600,000), the payments are not parachute payments.

(h) *Calculating present value—(1) In general.* Except as otherwise provided in this paragraph (h), for purposes of determining if a payment contingent on a separation from employment exceeds 3-times the base amount, the present value of a payment is determined as of the date of the separation from employment or, if the payment is made prior to that date, the date on which the payment is made.

(2) *Deferred payments.* For purposes of determining whether a payment is a parachute payment, if a payment in the nature of compensation is the right to receive payments in a year (or years) subsequent to the year of the separation from employment, the value of the payment is the present value of the payment (or payments) calculated on the basis of reasonable actuarial assumptions and using the applicable discount rate for the present value calculation that is determined in accordance with paragraph (i) of this section.

(3) *Health care.* If the payment in the nature of compensation is an obligation to provide health care (including an obligation to purchase or provide health insurance), then, for purposes of this paragraph (h) and for applying the 3-times-base-amount test under paragraph (g) of this section, the present value of the obligation is calculated in accordance with generally accepted accounting principles. For purposes of paragraph (g) of this section and this paragraph (h), the obligation to provide health care is permitted to be measured by projecting the cost of premiums for health care insurance, even if no health care insurance is actually purchased. If the obligation to provide health care is made in coordination with a health care plan that the employer makes available to a group, then the premiums used for purposes of this paragraph (h)(3) may be the allocable portion of group premiums.

(i) *Discount rate.* Present value generally is determined by using a discount rate equal to 120 percent of the applicable Federal rate (determined under section 1274(d) and the regulations in part 1 under section 1274(d)), compounded semiannually. The applicable Federal rate to be used is the Federal rate that is in effect on the date as of which the present value is determined, using the period until the payment

is expected to be made as the term of the debt instrument under section 1274(d). See paragraph (h) of this section for rules with respect to the date as of which the present value is determined. However, for any payment, the employer and the covered employee may elect to use the applicable Federal rate that is in effect on the date on which the parties entered into the contract that provides for the payment if that election is set forth in writing in the contract.

(j) *Present value of a payment to be made in the future that is contingent on an uncertain future event or condition*—(1) *Treatment based on the estimated probability of payment.* In certain cases, it may be necessary to apply the 3-times-base-amount test to a payment that is contingent on separation from employment at a time when the aggregate present value of all the payments is uncertain because the time, amount, or right to receive one or more of the payments is also contingent on the occurrence of an uncertain future event or condition. In that case, the employer must reasonably estimate whether it will make the payment. If the employer reasonably estimates there is a 50-percent or greater probability that it will make the payment, the full amount of the payment is considered for purposes of the 3-times-base-amount test and the allocation of the base amount. If the employer reasonably estimates there is a less than 50-percent probability that the payment will be made, the payment is not considered for either purpose.

(2) *Correction of incorrect estimates.* If an ATEO later determines that an estimate it made under paragraph (j)(1) of this section was incorrect, it must reapply the 3-times-base-amount test to reflect the actual time and amount of the payment. In reapplying the 3-times-base-amount test (and, if necessary, reallocating the base amount), the ATEO must determine the aggregate present value of payments paid or to be paid as of the date described in paragraph (h) of this section using the discount rate described in paragraph (i) of this section. This redetermination may affect the amount of any excess parachute payment for a prior taxable year. However, if, based on the application of the 3-times-base-amount test without regard to the payment described in this paragraph

(j), an ATEO has determined it will pay an employee an excess parachute payment or payments, then the 3-times-base-amount test does not have to be reapplied when a payment described in this paragraph (j) is made (or becomes certain to be made) if no base amount is allocated to that payment under §53.4960-4(d)(5).

(3) *Initial option value estimate.* To the extent provided in published guidance of general applicability under §601.601(d)(2), an initial estimate of the value of an option subject to paragraph (c) of this section is permitted to be made, with the valuation subsequently redetermined and the 3-times-base-amount test reapplied. Until guidance is published under section 4960, published guidance of general applicability described in §601.601(d)(2) that is issued under section 280G applies by analogy.

(4) *Examples.* See §1.280G-1, Q/A-33(d) for examples that may be applied by analogy to illustrate the rules of this paragraph (j).

(k) *Base amount*—(1) *In general.* A covered employee's base amount is the average annual compensation for services performed as an employee of the ATEO (including compensation for services performed for a predecessor of the ATEO), and/or, if applicable, a related organization, with respect to which there has been a separation from employment, if the compensation was includible in the gross income of the individual for taxable years in the base period (including amounts that were excluded under section 911) or that would have been includible in the individual's gross income if the individual had been a United States citizen or resident. See paragraph (l) of this section for the definition of base period and for examples of base amount computations.

(2) *Short or incomplete taxable years.* If the base period of a covered employee includes a short taxable year or less than all of a taxable year of the employee, compensation for the short or incomplete taxable year must be annualized before determining the average annual compensation for the base period. In annualizing compensation, the frequency with which payments are expected to be made over an annual period must be taken into account. Thus, any amount of compensation for a short or incomplete taxable year that rep-

resents a payment that will not be made more often than once per year is not annualized.

(3) *Excludable fringe benefits.* Because the base amount includes only compensation that is includible in gross income, the base amount does not include certain items that may constitute parachute payments. For example, payments in the form of excludable fringe benefits or excludable health care benefits are not included in the base amount but may be treated as parachute payments.

(4) *Section 83(b) income.* The base amount includes the amount of compensation included in income under section 83(b) during the base period.

(l) *Base period*—(1) *In general.* The base period of a covered employee is the covered employee's 5 most-recent taxable years ending before the date on which the separation from employment occurs. However, if the covered employee was not an employee of the ATEO for this entire 5-year period, the individual's base period is the portion of the 5-year period during which the covered employee performed services for the ATEO, a predecessor, or a related organization.

(2) *Determination of base amount if employee separates from employment in the year hired.* If a covered employee commences services as an employee and experiences a separation from employment in the same taxable year, the covered employee's base amount is the annualized compensation for services performed for the ATEO (or a predecessor or related organization) that was not contingent on the separation from employment and either was includible in the employee's gross income for that portion of the employee's taxable year prior to the employee's separation from employment (including amounts that were excluded under section 911) or would have been includible in the employee's gross income if the employee had been a United States citizen or resident.

(3) *Examples.* The following examples illustrate the rules of paragraph (k) of this section and this paragraph (l). For purposes of these examples, assume any entity referred to as "ATEO" is an ATEO, any entity referred to as "CORP" is not an ATEO, and all employees are HCEs of their respective employers.

(i) *Example 1 (Calculation with salary deferrals)*—(A) *Facts*. Employee A, a covered employee of ATEO 1, receives an annual salary of \$500,000 per year during the 5-year base period. Employee A defers \$100,000 of salary each year under a nonqualified deferred compensation plan (none of which is includible in Employee A's income until paid in cash to Employee A).

(B) *Conclusion*. Employee A's base amount is \$400,000 $((\$400,000 \times 5) / 5)$.

(ii) *Example 2 (Calculation for less-than-5-year base period)*—(A) *Facts*. Employee B, a covered employee of ATEO 1, was employed by ATEO 1 for 2 years and 4 months preceding the year in which Employee B separates from employment. Employee B's compensation includible in gross income was \$100,000 for the 4-month period, \$420,000 for the first full year, and \$450,000 for the second full year.

(B) *Conclusion*. Employee B's base amount is \$390,000 $((\$3 \times \$100,000) + \$420,000 + \$450,000) / 3$. Any compensation Employee B receives in the year of separation from employment is not included in the base amount calculation.

(iii) *Example 3 (Calculation for less-than-5-year base period with signing bonus)*—(A) *Facts*. Assume the same facts as in paragraph (i)(3)(ii)(A) of this section (Example 2), except that Employee B also received a \$60,000 signing bonus when Employee B's employment with ATEO 1 commenced at the beginning of the 4-month period.

(B) *Conclusion*. Employee B's base amount is \$410,000 $((\$60,000 + (\$3 \times \$100,000)) + \$420,000 + \$450,000) / 3$. Pursuant to paragraph (k)(2) of this section, because the bonus is a payment that will not be paid more often than once per year, the bonus is not taken into account in annualizing Employee B's compensation for the 4-month period.

(iv) *Example 4 (Effect of non-employee compensation)*—(A) *Facts*. Employee C, a covered employee of ATEO 1, was not an employee of ATEO 1 for the full 5-year base period. In 2024 and 2025, Employee C is only a director of ATEO 1 and receives \$30,000 per year for services as a director. On January 1, 2026, Employee C becomes an officer and covered employee of ATEO 1. Employee C's includible compensation for services as an officer of ATEO 1 is \$250,000 for each of 2026 and 2027, and \$300,000 for 2028. In 2028, Employee C separates from employment with ATEO 1.

(B) *Conclusion*. Employee C's base amount is \$250,000 $((2 \times \$250,000) / 2)$. The \$30,000 of director's fees paid to Employee C in each of 2024 and 2025 is not included in Employee C's base amount calculation because it was not for services performed as an employee of ATEO 1.

§53.4960-4 Liability for tax on excess remuneration and excess parachute payments.

(a) *Liability, reporting, and payment of excise taxes*—(1) *Liability*. For each taxable year, with respect to each covered employee, the taxpayer is liable for tax at the rate imposed under section 11 on the sum of the excess remuneration allocated

to the taxpayer under paragraph (c) of this section and, if the taxpayer is an ATEO, any excess parachute payment paid by the taxpayer or a predecessor during the taxable year.

(2) *Reporting and payment*. The excise tax imposed by section 4960 is reported as provided in §§53.6011-1(b) and 53.6071-1(i) and paid in the form and manner prescribed by the Commissioner.

(3) *Arrangements between an ATEO and a related organization*. Calculation of, and liability for, the excise tax imposed by section 4960 is separate from, and unaffected by, any arrangement that an ATEO and any related organization may have for bearing the cost of any liability for the excise tax imposed by section 4960.

(4) *Certain foreign related organizations*. A related organization that is a foreign organization described in section 4948(b) that either is exempt from tax under section 501(a) or is a taxable private foundation (section 4948(b) related organization) is not liable for the excise tax imposed by section 4960. A foreign organization is an organization not created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States. See section 4948(b) and §53.4948-1. For purposes of this paragraph (a)(4) and the application of section 4960 to a taxable year, an organization's status as a section 4948(b) related organization is determined at the end of its taxable year. However, remuneration that the section 4948(b) related organization pays to a covered employee of an ATEO must be taken into account by the ATEO and other related organizations for purposes of section 4960 generally, including for purposes of determining the five highest-compensated employees and the total remuneration paid to a covered employee. For example, if an ATEO and its related organization that is a section 4948(b) related organization each paid \$600,000 remuneration to a covered employee during the applicable year, then the related organization would not be liable for the tax that would otherwise be allocable to it, and the ATEO would be liable for tax on \$100,000 (50 percent of the \$200,000 excess remuneration paid to the employee).

(5) [Reserved].

(b) *Amounts subject to tax*—(1) *Excess remuneration*—(i) *In general*. *Excess remuneration* means the amount of remuneration paid by an ATEO to any covered employee during an applicable year in excess of \$1 million, as determined under §53.4960-2.

(ii) *Exclusion for excess parachute payments*. Excess remuneration does not include any amount that is an excess parachute payment as defined in paragraph (b)(2) of this section.

(2) *Excess parachute payment*. *Excess parachute payment* means an amount equal to the excess (if any) of the amount of any parachute payment paid by an ATEO, a predecessor of the ATEO, or a related organization, or on behalf of any such person, during the taxable year over the portion of the base amount allocated to such payment.

(c) *Calculation of liability for tax on excess remuneration*—(1) *In general*. For each taxable year, an employer is liable for the tax on excess remuneration paid in the applicable year ending with or within the employer's taxable year. If, for the taxable year, remuneration paid during an applicable year by an ATEO or one or more related organizations to a covered employee is taken into account in determining the tax imposed on excess remuneration for that taxable year, then each employer is liable for the tax in an amount that bears the same ratio to the total tax determined under section 4960(a) as the amount of remuneration paid by the employer to the covered employee (including remuneration paid by the employer as described in §53.4960-2(b)(1), but disregarding remuneration treated as paid by the employer under §53.4960-2(b)(2)), bears to the total amount of remuneration paid by the ATEO under §53.4960-2 (including remuneration treated as paid by the ATEO under §53.4960-2(b)(2)).

(2) *Calculation if liability is allocated from more than one ATEO with regard to an individual*. If liability for the tax on excess remuneration is allocated to an employer from more than one ATEO in a taxable year with regard to an individual that is a covered employee of each ATEO, then the employer is liable for the tax only in the capacity in which it is liable for the greatest amount of the tax with respect to that individual for the taxable year. For

example, assume ATEO 1 is a related organization to both ATEO 2 and ATEO 3 and pays excess remuneration to Employee D, and Employee D is a covered employee of ATEO 1, ATEO 2, and ATEO 3. In this case, ATEO 1's liability for the tax on excess remuneration to Employee D is the highest of its liability as an ATEO, as a related organization to ATEO 2, or as a related organization to ATEO 3.

(3) *Calculation if liability is allocated from an ATEO with a short applicable year.* If liability for the tax on excess remuneration paid to an individual is allocated to an employer from an ATEO with a short applicable year under §53.4960-1(c)(3), then the liability with respect to the excess remuneration paid to that individual is allocated in accordance with the principles of this paragraph (c) adjusted as necessary to avoid, to the extent possible, duplication of application of the excise tax. The Commissioner may provide additional guidance of general applicability, published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter), on the application of this paragraph (c) (3) to particular circumstances, including circumstances involving an ATEO with a short applicable year that has one or more related organizations and the ATEO's short applicable year and the preceding applicable year both end with or within the related organization's taxable year, such that the ATEO and related organizations are liable for the tax for multiple applicable years ending with or within the employer's taxable year.

(4) *Examples.* The following examples illustrate the rules of this paragraph (c). For purposes of these examples, assume that the rate of excise tax under section 4960 is 21 percent, that any entity that is referred to as "ATEO" is an ATEO, that any entity referred to as "CORP" is not an ATEO and is not a publicly held corporation within the meaning of section 162(m)(2) or a covered health insurance provider within the meaning of section 162(m)(6)(C), that no related organization is a section 4948(b) related organization, all taxpayers use the calendar year as their taxable year unless otherwise stated, and that no parachute payments are made in any of the years at issue.

(i) *Example 1 (Remuneration from multiple employers)*—(A) *Facts.* ATEO 1 and CORP 1 are related organizations. Employee A is a covered employee

of ATEO 1 and an employee of CORP 1. In the 2022 applicable year, ATEO 1 pays Employee A \$1.2 million of remuneration, and CORP 1 pays A \$800,000 of remuneration. Remuneration paid by each employer is for services performed by Employee A solely as an employee of that employer.

(B) *Conclusion.* For the 2022 taxable year, ATEO 1 is treated as paying Employee A \$2 million of remuneration, \$1 million of which is excess remuneration. The total excise tax is \$210,000 (21 percent x \$1 million). ATEO 1 paid 3/5 of Employee A's total remuneration (\$1.2 million / \$2 million); thus, ATEO 1 is liable for 3/5 of the excise tax, which is \$126,000. CORP 1 paid 2/5 of Employee A's total remuneration (\$800,000 / \$2 million); thus, CORP 1 is liable for 2/5 of the excise tax, which is \$84,000.

(ii) *Example 2 (Application when taxpayers have different taxable years)*—(A) *Facts.* Assume the same facts as in paragraph (c)(4)(i) of this section (*Example 1*), except that CORP 2 uses a taxable year beginning July 1 and ending June 30.

(B) *Conclusion.* The conclusion is the same as the conclusion in paragraph (c)(4)(i) of this section (*Example 1*), except that ATEO 1 is liable for the tax for its taxable year starting January 1, 2022, and ending December 31, 2022, and CORP 1 is liable for the tax for its taxable year beginning July 1, 2022, and ending June 30, 2023 (the taxable year with or within which ATEO 1's 2022 applicable year ends).

(iii) *Example 3 (Multiple liabilities for same applicable year due to multiple ATEOs)*—(A) *Facts.* The following facts are all with respect to the 2023 applicable year: ATEO 5 owns 60 percent of the stock of CORP 2. Sixty percent of ATEO 4's directors are representatives of ATEO 3. In addition, 60 percent of ATEO 5's directors are representatives of ATEO 4, but none are representatives of ATEO 3. Employee B is a covered employee of ATEO 3, ATEO 4, and ATEO 5 and is an employee of CORP 2. ATEO 3, ATEO 4, ATEO 5, and CORP 2 each pay Employee B \$1.2 million of remuneration in the applicable year. ATEO 4's related organizations are ATEO 3 and ATEO 5. ATEO 3's only related organization is ATEO 4. ATEO 5's related organizations are ATEO 4 and CORP 2.

(B) *Calculation (ATEO 3).* Under ATEO 3's calculation as an ATEO for the 2023 applicable year, ATEO 3 is treated as paying Employee B a total of \$2.4 million in remuneration (\$1.2 million from ATEO 3 + \$1.2 million from ATEO 4). The total excise tax is \$294,000 (21 percent x \$1.4 million). ATEO 3 and ATEO 4 each paid 1/2 of Employee B's total remuneration (\$1.2 million / \$2.4 million); thus, under ATEO 3's calculation, ATEO 3 and ATEO 4 each would be liable for 1/2 of the excise tax, which is \$147,000.

(C) *Calculation (ATEO 4).* Under ATEO 4's calculation as an ATEO for the 2023 applicable year, ATEO 4 is treated as paying Employee B a total of \$3.6 million in remuneration for the 2022 applicable year (\$1.2 million from ATEO 3 + \$1.2 million from ATEO 4 + \$1.2 million from ATEO 5). The total excise tax is \$546,000 (21 percent x \$2.6 million). ATEO 3, ATEO 4, and ATEO 5 each paid 1/3 of the total remuneration to Employee B (\$1.2 million / \$3.6 million); thus, under ATEO 4's calculation, ATEO 3, ATEO 4, and ATEO 5 each would be liable for 1/3 of the excise tax, which is \$182,000.

(D) *Calculation (ATEO 5).* Under ATEO 5's calculation as an ATEO for the 2023 applicable year, ATEO 5 is treated as paying Employee B a total of \$3.6 million in remuneration (\$1.2 million from ATEO 4 + \$1.2 million from ATEO 5 + \$1.2 million from CORP 2). The total excise tax is \$546,000 (21 percent x \$2.6 million). ATEO 4, ATEO 5, and CORP 2 each paid 1/3 of the total remuneration to Employee B (\$1.2 million / \$3.6 million); thus, under ATEO 5's calculation, ATEO 4, ATEO 5, and CORP 2 each would be liable for 1/3 of the excise tax, which is \$182,000.

(E) *Conclusion (Liability of ATEO 3).* For the 2023 applicable year, ATEO 3 is liable for \$182,000 of excise tax as a related organization under ATEO 4's calculation, which is greater than the \$147,000 of excise tax under ATEO 3's own calculation. Thus, ATEO 3's excise tax liability with respect to Employee B is \$182,000 for its 2023 taxable year.

(F) *Conclusion (Liability of ATEO 4).* For the 2023 applicable year, ATEO 4 is liable as a related organization for \$147,000 of excise tax according to ATEO 3's calculation, for \$182,000 according to ATEO 4's own calculation, and for \$182,000 according to ATEO 5's calculation. Thus, ATEO 4's excise tax liability with respect to Employee B is \$182,000 for its 2023 taxable year.

(G) *Conclusion (Liability of ATEO 5).* For the 2023 applicable year, ATEO 5 is liable as a related organization for \$182,000 of excise tax under ATEO 4's calculation, and is liable for \$182,000 of excise tax under ATEO 5's own calculation. Thus, ATEO 5's excise tax liability with respect to Employee B is \$182,000 for its 2023 taxable year.

(H) *Conclusion (Liability of CORP 2).* For the 2023 applicable year, CORP 2 is liable as a related organization for \$182,000 of excise tax according to ATEO 5's calculation only. Thus, CORP 2's excise tax liability with respect to Employee B is \$182,000 for its 2023 taxable year.

(d) *Calculation of liability for excess parachute payments*—(1) *In general.* Except as provided in paragraph (d)(3) of this section, only excess parachute payments made by or on behalf of an ATEO are subject to tax under this section. However, parachute payments made by related organizations that are not made by or on behalf of an ATEO are taken into account for purposes of determining the total amount of excess parachute payments.

(2) *Computation of excess parachute payments*—(i) *Calculation.* The amount of an excess parachute payment is the excess of the amount of any parachute payment made by an ATEO, a predecessor of the ATEO, or a related organization, or on behalf of any such person, over the portion of the covered employee's base amount that is allocated to the payment. The portion of the base amount allocated to any parachute payment is the amount that bears the same ratio to the base amount as the present value of the parachute pay-

ment bears to the aggregate present value of all parachute payments made or to be made to (or for the benefit of) the same covered employee. Thus, the portion of the base amount allocated to any parachute payment is determined by multiplying the base amount by a fraction, the numerator of which is the present value of the parachute payment and the denominator of which is the aggregate present value of all parachute payments.

(ii) *Examples.* The following examples illustrate the rules of this paragraph (d) (2). For purposes of these examples, assume any entity referred to as “ATEO” is an ATEO and all employees are HCEs of their respective employers.

(A) *Example 1 (Compensation from related organizations)*—(1) *Facts.* ATEO 1 and ATEO 2 are related organizations. Employee A is a covered employee of ATEO 1 and an employee of ATEO 2 who has an involuntary separation from employment with ATEO 1 and ATEO 2. Employee A’s base amount is \$200,000 with respect to ATEO 1 and \$400,000 with respect to ATEO 2. A receives \$1 million from ATEO 1 contingent upon Employee A’s involuntary separation from employment from ATEO 1 and \$1 million from ATEO 2 contingent upon Employee A’s involuntary separation from employment from ATEO 2.

(2) *Conclusion.* Employee A has a base amount of \$600,000 (\$200,000 + \$400,000). The two \$1 million payments are parachute payments because their aggregate present value is at least 3-times Employee A’s base amount ($3 \times \$600,000 = \1.8 million). The portion of the base amount allocated to each parachute payment is \$300,000 ($(\$1 \text{ million} / \$2 \text{ million}) \times \$600,000$). Thus, the amount of each excess parachute payment is \$700,000 ($\$1 \text{ million} - \$300,000$).

(B) *Example 2 (Multiple parachute payments)*—(1) *Facts.* Employee B is a covered employee of ATEO 3 with a base amount of \$200,000 who is entitled to receive two parachute payments: one of \$200,000 and the other of \$900,000. The \$200,000 payment is made upon separation from employment, and the \$900,000 payment is to be made on a date in a future taxable year. The present value of the \$900,000 payment is \$800,000 as of the date of the separation from employment.

(2) *Conclusion.* The portion of the base amount allocated to the first payment is \$40,000 ($(\$200,000 \text{ present value of the parachute payment} / \$1 \text{ million present value of all parachute payments}) \times \$200,000 \text{ total base amount}$) and the portion of the base amount allocated to the second payment is \$160,000 ($(\$800,000 \text{ present value of the parachute payment} / \$1 \text{ million present value of all parachute payments}) \times \$200,000 \text{ total base amount}$). Thus, the amount of the first excess parachute payment is \$160,000 ($\$200,000 - \$40,000$) and that the amount of the second excess parachute payment is \$740,000 ($\$900,000 - \$160,000$).

(3) *Reallocation when the payment is disproportionate to base amount.* In accordance with section 4960(d), the Com-

missioner may treat a parachute payment as paid by an ATEO if the facts and circumstances indicate that the ATEO and other payors of parachute payments structured the payments in a manner primarily to avoid liability under section 4960. For example, if an ATEO would otherwise be treated as paying a portion of an excess parachute payment in an amount that is materially lower in proportion to the total excess parachute payment than the proportion that the amount of average annual compensation paid by the ATEO (or any predecessor) during the base period bears to the total average annual compensation paid by the ATEO (or any predecessor) and any related organization (or organizations), and the lower amount is offset by payments from a non-ATEO or an unrelated ATEO, this may indicate that the parachute payments were structured in a manner primarily to avoid liability under section 4960.

(4) *Election to prepay tax.* An ATEO may prepay the excise tax under paragraph (a)(1) of this section on any excess parachute payment for the taxable year of the separation from employment or any later taxable year before the taxable year in which the parachute payment is actually or constructively paid. However, an employer may not prepay the excise tax on a payment to be made in cash if the present value of the payment is not reasonably ascertainable under §31.3121(v) (2)-1(e)(4) or on a payment related to health coverage. Any prepayment must be based on the present value of the excise tax that would be due for the taxable year in which the employer will pay the excess parachute payment, and be calculated using the discount rate equal to 120 percent of the applicable Federal rate (determined under section 1274(d) and the regulations in part 1 under section 1274) and the tax rate in effect under section 11 for the year in which the excise tax is paid. For purposes of projecting the future value of a payment that provides for interest to be credited at a variable interest rate, the employer may make a reasonable assumption regarding the variable rate. An employer is not required to adjust the excise tax paid merely because the actual future interest rates are not the same as the rate used for purposes of projecting the future value of the payment.

(5) *Liability after a redetermination of total parachute payments.* If an ATEO determines that an estimate made under §53.4960-3(j)(1) was incorrect, it must reapply the 3-times-base-amount test to reflect the actual time and amount of the payment. In reapplying the 3-times-base-amount test (and, if necessary, reallocating the base amount), the ATEO must determine the correct base amount allocable to any parachute payment paid in the taxable year. See §1.280G-1, Q/A-33(d) for examples that may be applied by analogy to illustrate the rules of this paragraph (d) (5).

(6) *Examples.* The following examples illustrate the rules of this paragraph (d). For purposes of these examples, assume any entity referred to as “ATEO” is an ATEO, any entity referred to as “CORP” is not an ATEO, and all employees are HCEs of their respective employers.

(i) *Example 1 (Excess parachute payment paid by a non-ATEO)*—(A) *Facts.* ATEO 1 and CORP 1 are related organizations that are treated as the same employer for purposes of §53.4960-3(e)(3) (defining separation from employment) and are both calendar year taxpayers. For 2022 through 2026, ATEO 1 and CORP 1 each pay Employee A \$250,000 of compensation per year for services performed as an employee of each organization (\$500,000 total per year). In 2027, ATEO 1 and CORP 1 each pay Employee A \$1 million payment (\$2 million total) that is contingent on Employee A’s separation from employment with both ATEO 1 and CORP 1, all of which is remuneration, and no other compensation. Employee A is a covered employee of ATEO 1 in 2027.

(B) *Conclusion.* Employee A’s base amount in 2027 is \$500,000 (Employee A’s average annual compensation from both ATEO 1 and CORP 1 for the previous 5 years). ATEO 1 makes a parachute payment of \$2 million in 2027, the amount paid by both ATEO 1 and CORP 1 that is contingent on Employee A’s separation from employment with ATEO 1 and all organizations that are treated as the same employer under §53.4960-3(e)(3). Employee A’s \$2 million payment exceeds 3-times the base amount (\$1.5 million). ATEO 1 makes a \$1.5 million excess parachute payment (the amount by which \$2 million exceeds the \$500,000 base amount). However, ATEO 1 is liable for tax only on the excess parachute payment paid by ATEO 1 ($\$1 \text{ million parachute payment} - \$250,000 \text{ base amount} = \$750,000$) that is subject to tax under §53.4960-4(a). CORP 1 is not liable for tax under §53.4960-4(a) in 2027.

(ii) *Example 2 (Election to prepay tax on excess parachute payments and effect on excess remuneration)*—(A) *Facts.* Employee B is a covered employee of ATEO 2 with a base amount of \$200,000 who is entitled to receive two parachute payments from ATEO 2, one of \$200,000 and the other of \$900,000. The \$200,000 payment is made upon separation from employment, and the \$900,000 payment is to be made on a date in a future taxable year. The pres-

ent value of the \$900,000 payment is \$800,000 as of the date of the separation from employment. ATEO 2 elects to prepay the excise tax on the \$900,000 future parachute payment (of which \$740,000 is an excess parachute payment). The tax rate under section 11 is 21 percent for the taxable year the excise tax is paid and, using a discount rate determined under §53.4960-3(i), the present value of the \$155,400 (\$740,000 x 21 percent) excise tax on the \$740,000 future excess parachute payment is \$140,000.

(B) *Conclusion.* The excess parachute payment is thus \$800,000 (\$200,000 plus \$800,000 present value of the \$900,000 future payment, less \$200,000 base amount), with \$40,000 of the base amount allocable to the \$200,000 payment and \$160,000 of the base amount allocable to the \$900,000 payment. To prepay the excise tax on the \$740,000 future excess parachute payment, the employer must satisfy its \$140,000 obligation under section 4960 with respect to the future payment, in addition to the \$33,600 excise tax (\$160,000 x 21 percent) on the \$160,000 excess parachute payment made upon separation

from employment. For purposes of determining the amount of excess remuneration (if any) under section 4960(a)(1), the amount of remuneration paid by the employer to the covered employee for the taxable year of the separation from employment is reduced by the \$900,000 of total excess parachute payments (\$160,000 + \$740,000).

§53.4960-5 [Reserved].

§53.4960-6 *Applicability date.*

(a) *General applicability date.* Sections 53.4960-0 through 53.4960-4 apply to taxable years beginning after December 31, 2021. Taxpayers may choose to apply §§53.4960-0 through 53.4960-4 to taxable years beginning after December 31, 2017, and on or before December 31, 2021, pro-

vided the taxpayer applies §§53.4960-0 through 53.4960-4 in their entirety and in a consistent manner.

(b) [Reserved].

Sunita Lough,
Deputy Commissioner for Services
and Enforcement.

Approved: January 9, 2021.

David J. Kautter,
Assistant Secretary of the Treasury
(Tax Policy).

(Filed by the Office of the Federal Register on January 15, 2021; 4:15pm and published in the issue of the Federal Register for January 19, 2021 86 F.R. 6196)

Part III

Extension of Relief for Qualified Opportunity Funds and Investors Affected by Ongoing Coronavirus Disease 2019 Pandemic

Notice 2021-10

I. PURPOSE

This notice provides additional relief under section 7508A of the Internal Revenue Code (Code) for qualified opportunity funds (QOFs) and their investors in response to the ongoing Coronavirus Disease 2019 (COVID-19) pandemic. This notice also provides additional relief pursuant to section 1400Z-2(f)(3) and Income Tax Regulations under section 1400Z-2 of the Code (section 1400Z-2 regulations). Specifically, this notice extends the relief for QOFs and their investors provided by Notice 2020-39, 2020-26 I.R.B. 984.

II. BACKGROUND

A. 180-Day Investment Requirement for QOF Investors

Section 1400Z-2(a)(1)(A) provides that if a taxpayer has “gain from the sale to, or exchange with, an unrelated person of any property held by the taxpayer” the taxpayer may elect to exclude from gross income for the taxable year “so much of such gain as does not exceed the aggregate amount invested by the taxpayer in a [QOF] during the 180-day period beginning on the date of such sale or exchange” (180-day investment requirement). Section 1.1400Z2(a)-1 provides definitions and rules to implement the 180-day investment requirement.

B. 30-Month Substantial Improvement Period for QOFs

Section 1400Z-2(d)(2)(D)(i) provides that tangible property is treated as qualified opportunity zone business property if the

tangible property is used in a trade or business of the QOF and satisfies three general requirements. One of these requirements is that the original use of post-2017 acquired tangible property in the qualified opportunity zone must begin with the QOF (referred to as the “original use requirement”), or the QOF must substantially improve that property (substantial improvement requirement). *See* section 1400Z-2(d)(2)(D)(i)(II). The substantial improvement requirement is met only if, during any 30-month period beginning after the date of acquisition of the post-2017 acquired tangible property, there are “additions to basis with respect to such property” held by the QOF that, in the aggregate, exceed the QOF’s adjusted basis of that property as of the beginning of that 30-month period (30-month substantial improvement period). *See* section 1400Z-2(d)(2)(D)(ii). Section 1.1400Z2(d)-2(b)(4) provides rules to implement the substantial improvement requirement.

C. 90-Percent Investment Standard for QOFs

Section 1400Z-2(d)(1) defines a QOF as any investment vehicle organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (other than another QOF). This definition also requires a QOF to hold at least 90 percent of its assets in qualified opportunity zone property, determined by the average of the percentage of qualified opportunity zone property held by that QOF as measured (i) on the last day of the first 6-month period of the taxable year of the QOF, and (ii) on the last day of the taxable year of the QOF. *See* section 1400Z-2(d)(1). The requirement that the average percentages of the QOF’s qualified opportunity zone property on these two dates (semi-annual testing dates) must equal at least 90 percent of the QOF’s assets is referred to as the 90-percent investment standard. *See* section 1400Z-2(f). Section 1.1400Z2(d)-1 provides definitions and rules to implement the 90-percent investment standard.

If the average of the percentages of the qualified opportunity zone proper-

ty held by a QOF on these semi-annual testing dates fails to meet the 90-percent investment standard, section 1400Z-2(f)(1) provides a general rule that the QOF must pay a penalty for each month that the QOF fails to meet that standard. However, section 1400Z-2(f)(3) provides that no such penalty is imposed “with respect to any failure if it is shown that such failure is due to reasonable cause.”

D. Working Capital Safe Harbor for Qualified Opportunity Zone Businesses

An entity must meet certain requirements to be a qualified opportunity zone business, including the requirement of section 1397C(b)(8) of the Code that less than 5 percent of the average of the aggregate unadjusted bases of the entity’s property be attributable to nonqualified financial property, as defined in section 1397C(e). *See* section 1400Z-2(d)(3)(A)(ii). Section 1397C(e) excludes from nonqualified financial property reasonable amounts of working capital that are held in cash, cash equivalents, or debt instruments with a term of 18 months or less. *See* § 1.1400Z2(d)-1(d)(3)(iv).

The section 1400Z-2 regulations provide qualified opportunity zone businesses with a safe harbor for treating an amount of working capital as reasonable for purposes of section 1397C(e) if certain requirements are satisfied (working capital safe harbor). *See* § 1.1400Z2(d)-1(d)(3)(v) (providing the scope of the working capital safe harbor and conditions for eligibility). One of those requirements is that there is a written schedule consistent with the ordinary start-up of a trade or business for the expenditure of the working capital assets within 31 months of the receipt by the business of the assets. *See* § 1.1400Z2(d)-1(d)(3)(v)(B). A qualified opportunity zone business may extend the working capital safe harbor period to a maximum 62-month period under § 1.1400Z2(d)-1(d)(3)(vi) if certain additional requirements are met.

If such qualified opportunity zone business is located in a qualified opportunity zone within a Federally declared disas-

ter (as defined in section 165(i)(5)(A) of the Code), the qualified opportunity zone business may receive not more than an additional 24 months to expend its working capital assets, as long as the qualified opportunity zone business otherwise meets the requirements of the working capital safe harbor. *See* § 1.1400Z2(d)-1(d)(3)(v)(D). Therefore, a qualified opportunity zone business may, if each applicable requirement of § 1.1400Z2(d)-1(d)(3)(v) and (vi) is satisfied, have up to a maximum 86-months to expend working capital assets if the qualified opportunity zone business is located in a qualified opportunity zone within a Federally declared disaster.

E. 12-Month Reinvestment Period for QOFs

The section 1400Z-2 regulations provide generally that, if (i) a QOF sells or disposes of some or all of its qualified opportunity zone property or if a distribution with respect to the QOF's qualified opportunity zone stock is treated as a return of capital in the QOF's hands, and if (ii) the QOF reinvests some or all of the proceeds in qualified opportunity zone property by the last day of the 12-month period beginning on the date of the distribution, sale, or disposition, then the proceeds, to the extent that they are so reinvested, are treated as qualified opportunity zone property for purposes of the 90-percent investment standard. *See* § 1.1400Z2(f)-1(b)(1). This treatment is available to a QOF only to the extent that, prior to the reinvestment in qualified opportunity zone property, the reinvested proceeds are continuously held in cash, cash equivalents, or debt instruments with a term of 18 months or less. *See id.*

If the QOF's plan to reinvest some or all of the above-described proceeds in qualified opportunity zone property is delayed due to a Federally declared disaster (as defined in section 165(i)(5)(A)), the QOF may receive not more than an

additional 12 months to reinvest the proceeds, provided that the QOF invests the proceeds in the manner originally intended before the disaster. *See* § 1.1400Z2(f)-1(b)(2).

F. Prior Grants of Relief

On April 9, 2020, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) issued Notice 2020-23 to provide relief under section 7508A(a) to taxpayers affected by the COVID-19 emergency by postponing due dates with respect to certain taxpayer and government acts. *See generally* Part III of Notice 2020-23 (providing relief for certain time-sensitive actions due to be performed on or after April 1, 2020, and before July 15, 2020), *amplifying* Notice 2020-20, 2020-16 I.R.B. 660 (April 13, 2020) and Notice 2020-18, 2020-15 I.R.B. 590 (April 6, 2020), and *modifying* Rev. Proc. 2014-42, 2014-29 I.R.B. 192 (July 1, 2014).

On June 4, 2020, the Treasury Department and the IRS issued Notice 2020-39 to provide relief under section 7508A(a) for QOFs and their investors in response to the COVID-19 pandemic, and to address the application of certain relief provisions in the section 1400Z-2 regulations. Specifically, Notice 2020-39 provided the following:

(1) *180-day investment requirement.* If the last day of the 180-day investment period within which a taxpayer must make an investment in a QOF in order to satisfy the 180-day investment requirement falls on or after April 1, 2020, and before December 31, 2020, the last day of that 180-day investment period is postponed to December 31, 2020.

(2) *30-month substantial improvement period.* For purposes of the substantial improvement requirement with respect to property held by a QOF or qualified opportunity zone business, the period beginning on April 1, 2020, and ending on December 31, 2020, is dis-

regarded in determining any 30-month substantial improvement period (that is, the 30-month substantial improvement period is tolled during the period beginning on April 1, 2020, and ending on March 31, 2021).

In addition, Notice 2020-39 provided the following:

(1) *90-percent investment standard.* In the case of a QOF whose (i) last day of the first 6-month period of the taxable year *or* (ii) last day of the taxable year falls within the period beginning on April 1, 2020, and ending on December 31, 2020, any failure by that QOF to satisfy the 90-percent investment standard for that taxable year of the QOF is (i) due to reasonable cause under section 1400Z-2(f)(3); and (ii) disregarded for purposes of determining whether the QOF or any otherwise qualifying investments in that QOF satisfy the requirements of section 1400Z-2 and the section 1400Z-2 regulations for any taxable year of the QOF.

(2) *Working capital safe harbor for qualified opportunity zone businesses.* As a result of the Emergency Declaration¹ (that is, the declaration of a Federally declared disaster for purposes of section 165(i)(5)(A)), all qualified opportunity zone businesses holding working capital assets intended to be covered by the working capital safe harbor before December 31, 2020, receive not more than an additional 24 months to expend the working capital assets of the qualified opportunity zone business, as long as the qualified opportunity zone business otherwise meets the requirements of § 1.1400Z2(d)-1(d)(3)(v) (that is, the requirements to qualify for the working capital safe harbor).

(3) *12-Month Reinvestment Period for QOFs.* If any QOF's 12-month reinvestment period includes January 20, 2020 (that is, the date of the disaster identified in the Major Disaster Declarations²), that QOF receives up to an additional 12 months to reinvest in qualified opportunity zone property some or all of the proceeds

¹ The term "Emergency Declaration" means the March 13, 2020, issuance by the President of the United States of an emergency declaration under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act) (42 U.S.C. 5121 et seq.) in response to the ongoing COVID-19 pandemic. For a description of the Emergency Declaration and section 7508A, *see generally* Part II.A of Notice 2020-39.

² The term "Major Disaster Declarations" means the major disaster declarations issued by the President, subsequent to the Emergency Declaration, under the authority of the Stafford Act with respect to all 50 states, the District of Columbia, and 5 territories. *See* <https://www.fema.gov/coronavirus/disaster-declarations>.

received by the QOF from the return of capital or the sale or disposition of some or all of the QOF's qualified opportunity zone property, provided that the QOF satisfies the requirements of § 1.1400Z2(f)-1(b)(1) and invests the proceeds in the manner originally intended before January 20, 2020.

III. EXTENSION OF RELIEF FOR QOF INVESTORS AND QOFS PROVIDED PURSUANT TO SECTION 7508A OF THE CODE

A. 180-Day Investment Requirement for QOF Investors

If the last day of the 180-day investment period within which a taxpayer must make an investment in a QOF in order to satisfy the 180-day investment requirement falls on or after April 1, 2020, and before March 31, 2021, the last day of that 180-day investment period is postponed to March 31, 2021. This relief is automatic; taxpayers do not have to call the IRS or send letters or other documents to the IRS to receive this relief. However, a taxpayer will still need to make a valid deferral election in accordance with the instructions to Form 8949, complete Form 8997, and file the completed Form 8949 and Form 8997 with a timely filed Federal income tax return (including extensions) or amended Federal income tax return for the taxable year in which the gain would be recognized if section 1400Z-2(a)(1) did not apply to defer recognition of the gain. For additional information, see <https://www.irs.gov/form8949> <https://www.irs.gov/form8997>.

B. 30-Month Substantial Improvement Period for QOFs and Qualified Opportunity Zone Businesses

For purposes of the substantial improvement requirement with respect to property held by a QOF or qualified opportunity zone business, the period beginning on April 1, 2020, and ending on March 31, 2021, is disregarded in determining any 30-month substantial improvement period (that is, the 30-month substantial improvement period is tolled during the period beginning on April 1, 2020, and ending on March 31, 2021).

IV. EXTENSION OF RELIEF FOR QOFS AND QUALIFIED OPPORTUNITY ZONE BUSINESSES PURSUANT TO SECTION 1400Z-2(f)(3) OF THE CODE AND SECTION 1400Z-2 REGULATIONS

A. 90-Percent Investment Standard for QOFS

In the case of a QOF whose (i) last day of the first 6-month period of a taxable year *or* (ii) last day of a taxable year falls within the period beginning on April 1, 2020, and ending on June 30, 2021, any failure by that QOF to satisfy the 90-percent investment standard for that taxable year of the QOF is due to reasonable cause under section 1400Z-2(f)(3). Thus, any failure by that QOF to satisfy the 90-percent investment standard for that taxable year is not taken into account for purposes of determining whether the QOF or any otherwise qualifying investments in that QOF satisfy the requirements of section 1400Z-2 and the section 1400Z-2 regulations for any taxable year of the QOF.

This relief is granted under section 1400Z-2(f)(3) and is automatic; QOFS do not have to call the IRS or send letters or other documents to the IRS to receive this relief. However, a QOF must accurately complete all lines on Form 8996 filed with respect to each affected taxable year EXCEPT that the QOF should place a "0" in Part IV, Line 8 (Penalty). The accurately completed Form 8996 must be filed with the QOF's timely filed Federal income tax return (including extensions) for the affected taxable year(s). For additional information, see <https://www.irs.gov/form8996>.

B. Working Capital Safe Harbor for Qualified Opportunity Zone Businesses

As a result of the Emergency Declaration (that is, the declaration of a Federally declared disaster for purposes of section 165(i)(5)(A)), all qualified opportunity zone businesses holding working capital assets intended to be covered by the working capital safe harbor before June 30, 2021, receive not more than an additional 24 months, including any relief provided

under Notice 2020-39, for a maximum safe harbor period of not more than 55 months total (not more than 86 months total for start-up businesses), to expend the working capital assets of the qualified opportunity zone business, as long as the qualified opportunity zone business otherwise meets the requirements of § 1.1400Z2(d)-1(d)(3)(v) (that is, the requirements to qualify for the working capital safe harbor). See § 1.1400Z2(d)-1(d)(3)(v)(D) (providing such 24-month extension due to a Federally declared disaster).

C. 12-Month Reinvestment Period for QOFS

If any QOF's 12-month reinvestment period includes June 30, 2020, that QOF receives not more than an additional 12 months, including any relief provided under Notice 2020-39, for a maximum reinvestment period of not more than 24 months total, to reinvest in qualified opportunity zone property some or all of the proceeds received by the QOF from the return of capital or the sale or disposition of some or all of the QOF's qualified opportunity zone property, provided that the QOF satisfies the requirements of § 1.1400Z2(f)-1(b)(1) and invests the proceeds in the manner originally intended before June 30, 2020. See § 1.1400Z2(f)-1(b)(2) (providing such 12-month extension due to a Federally declared disaster).

V. EFFECT ON OTHER DOCUMENTS

Notice 2020-23 is modified. Notice 2020-39 is amplified.

VI. DRAFTING INFORMATION

The principal author of this notice is Kyle C. Griffin of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice, you may call the COVID-19 Disaster Relief Hotline at (202) 317-5436 (not a toll-free number). For further information regarding the application of this notice to section 1400Z-2 and the section 1400Z-2 regulations, please contact Mr. Griffin at (202) 317-4718 (not a toll-free number).

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the

new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the

new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.

ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
FR—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.

PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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¹ A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2020–27 through 2020–52 is in Internal Revenue Bulletin 2020–52, dated December 27, 2020.

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¹ A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2020–27 through 2020–52 is in Internal Revenue Bulletin 2020–52, dated December 27, 2020.

Internal Revenue Service

Washington, DC 20224

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INTERNAL REVENUE BULLETIN

The Introduction at the beginning of this issue describes the purpose and content of this publication. The weekly Internal Revenue Bulletins are available at www.irs.gov/irb/.

We Welcome Comments About the Internal Revenue Bulletin

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